

NOWALSKY, BRONSTON & GOTHARD

A Professional Limited Liability Company

Attorneys at Law

3500 N. Causeway Boulevard
Suite 1442

Metairie, Louisiana 70002

Telephone: (504) 832-1984

Facsimile: (504) 831-0892

Leon L. Nowalsky
Benjamin W. Bronston
Edward P. Gothard

Monica R. Borne
EllenAnn G. Sands

February 7, 2000

VIA AIRBORNE EXPRESS

Chief Clerk
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

PAID T.R.A.	
Chk #	<u>5610</u>
Amount	<u>25.00</u>
Rcvd By	<u>JR</u>
Date	<u>2-9-00</u>

00-00096

Re: Application by International Exchange Communications, Inc.
d/b/a ("IECOM") and NOSVA Limited Partnership for
Approval of an Asset Purchase Agreement

Dear Sir or Madam:

On behalf of International Exchange Communications, Inc. ("IECOM") and NOSVA Limited Partnership, enclosed please find an original and thirteen (13) copies of the referenced Application. Also enclosed is a check in the amount of \$25.00 to cover the cost of the filing.

Please date stamp and return the enclosed extra copy of this letter in the envelope provided.

Please call me should you have any questions concerning this filing. Thank you for your assistance with this matter.

Sincerely,


EllenAnn Sands

EAS/rph

Enclosures

POSTED
2-9-2000

00-00096

BEFORE THE TENNESSEE REGULATORY AUTHORITY

STATE OF TENNESSEE

**JOINT APPLICATION OF INTERNATIONAL
EXCHANGE COMMUNICATIONS, INC.
D/B/A IE COM AND NOSVA LIMITED
PARTNERSHIP FOR APPROVAL OF AN
ASSET PURCHASE AGREEMENT**

DOCKET NUMBER _____

APPLICATION

International Exchange Communications, Inc. ("IE COM") and NOSVA Limited Partnership ("NOSVA") (sometimes referred to jointly herein as "Applicants"), pursuant to the applicable Statutes of Tennessee and the Regulatory Authority's Rules and Regulations currently in effect and/or subsequently enacted, hereby request approval of a proposed Asset Purchase Agreement (the "Agreement").¹ As will be described in more detail below, the Agreement contemplates the purchase by IE COM of the international operating division of NOSVA which markets under the names "International Plus" and "O11 Communications." IE COM proposes to acquire the customer accounts ("Customer Accounts") and related assets of NOSVA's international division (the "Assets") and to begin to provide long distance service to those customers of NOSVA under the Certificate of Public Convenience and Necessity, or other operating authority, previously issued to IE COM. As regulated telecommunications providers, IE COM and NOSVA hereby seek Commission approval of the Agreement and the transactions contemplated thereby (the "Acquisition").

Commission approval of the Agreement will be beneficial to the involved companies as well as their customers. Following consummation of the Agreement and integration of NOSVA's back

¹ A copy of the proposed Asset Purchase Agreement is attached as Exhibit "A."

office technology, IE COM will be able to provide telecommunications services to its customers in a more efficient manner. Approval of the Agreement will not in any way be detrimental to the public interests of the State of Tennessee. The customers of both IE COM and NOSVA, including the customers whose accounts will be transferred pursuant to the Agreement, will continue to receive the same high quality service presently rendered to them. Additionally, no party to the Agreement will be given an undue advantage over any other party.

In support of this Application, Applicants show the following:

I. THE PARTIES

1. IE COM is a Delaware corporation which is a wholly owned subsidiary of Pacific Gateway Exchange, Inc., a Delaware corporation which is publicly traded on the NASDAQ National Market (hereinafter "PGEX"). IE COM's principal offices are located at 533 Airport Blvd., Suite 505, Burlingame, CA 94010. IE COM is a non-dominant carrier that provides domestic and international long distance service with its own facilities or through resale of purchased services from various facilities based carriers pursuant to the FCC's *Competitive Carrier* policies and is authorized to provide local service in accordance with applicable state competitive local exchange service rules and regulations.

2. IE COM is authorized by the FCC to offer domestic interstate and international services in all fifty (50) states and the District of Columbia as a non-dominant carrier. IE COM currently originates interstate traffic in fifty (50) states, and provides intrastate service, pursuant to certification, registration or tariff requirements, or on an unregulated basis, in fifty (50) states. IE COM is a certificated carrier in the State of Tennessee.²

3. NOSVA is a privately held Maryland limited partnership with principal offices

² IE COM is certificated in this State, pursuant to authority granted in Docket No. 98-00048, granted on September 14, 1999.

located at 4380 Boulder Highway, Las Vegas, NV 89121. NOSVA is a non-dominant carrier that resells domestic and international long distance service from various facilities based carriers pursuant to the FCC's *Competitive Carrier* policies.

4. NOSVA is authorized by the FCC to offer domestic interstate and international services in all fifty (50) states and the District of Columbia as a non-dominant carrier. NOSVA currently originates interstate traffic in forty-eight (48) states, and provides intrastate service, pursuant to certification, registration or tariff requirements, or on an unregulated basis, in forty-eight (48) states. NOSVA is a certificated carrier in the State of Tennessee. ³

II. DESIGNATED CONTACT

5. The designated contact for questions concerning this Application is:

EllenAnn G. Sands
Nowalsky, Bronston & Gothard
A Professional Limited Liability Company
3500 North Causeway Boulevard
Suite 1442
Metairie, Louisiana 70002
Telephone: (504) 832-1984
Fax: (504) 831-0892

6. Copies of such correspondence should also be sent to:

NOSVA Limited Partnership
Attn: Michael Arnau, Chief Executive Officer
4380 Boulder Highway
Las Vegas, NV 89121

and

International Exchange Communications, inc.
Attn: Gail E. Granton
533 Airport Blvd., Suite 505
Burlingame, CA 94010

³ NOSVA is certificated in this State, pursuant to authority granted in Docket No. 95-03301, granted on November 10, 1995.

III. REQUEST FOR APPROVAL OF THE ASSET PURCHASE AGREEMENT

7. Applicants propose a transaction which will accomplish the following:
 - a. NOSVA shall sell, transfer and assign to IE COM all of NOSVA's right, title and interest in and to NOSVA's international division, as described in the Agreement ;
 - b. In consideration for the above transfer and sale of assets, IE COM will pay to NOSVA the purchase consideration set forth in the Agreement; and
 - c. The assets to be purchased by IE COM include the Customer Accounts.

8. IE COM is well-qualified to consummate the transaction which is the subject of this Application. Current financial information for IE COM is included in the financial statements of IE COM's publicly held parent company, PGEX, which are attached hereto as Exhibit "B".⁴

9. IE COM proposes this transaction to transfer and consolidate the Customer Accounts in order to create a single, larger provider of telecommunications facilitating efficiencies for the benefit of IE COM's customers. By virtue of these transactions, IE COM will realize significant economic, marketing and administrative efficiencies.

10. Following consummation of the transaction discussed above, all of the Customer Accounts will be transferred to IE COM, and IE COM will continue to service these customers through and pursuant to the Certificate of Public Convenience and Necessity, or other operating authority, presently utilized by IE COM in servicing its existing customers in this State, to the extent permitted by the Commission.⁵

⁴ Exhibit "B" consists of PGEX's Report on Form 10Q for the period ending September 30, 1999.

⁵ Upon consummation of the proposed transaction, IE COM intends to notify all current end users of NOSVA of the Acquisition and that no customers of NOSVA will experience any change in rates due to the transaction by bill insert, a sample copy of which is attached hereto as Exhibit "D". To the extent that any present NOSVA rate products are eventually changed or are not presently included in IE COM's Tariffs, IE COM will amend its Tariffs accordingly to include such rates. As a result, the transaction should not cause any inconvenience or confusion to the customers of either NOSVA or IE COM. In no event shall the customers of either NOSVA or IE COM incur any increase in rates presently enjoyed by them.

11. The technical, managerial and financial personnel of NOSVA will assist with the transition and integration of the acquired Assets after the transaction, and along with the technical, managerial and financial personnel of IE COM, will continue to serve the transferred NOSVA customers with the same high level of expertise.

IV. PUBLIC INTEREST CONSIDERATIONS

12. Critical to the Acquisition and subsequent consolidation of Customer Accounts is the need to ensure the continuation of high quality service to all customers currently served by NOSVA.

The proposed transaction will serve the public interest for the following reasons:

- a. It will enable IE COM to provide a streamlined level of service for all involved customers by creating a single, larger operation to provide long distance service to the customers in this State as well as other states. The transaction will enhance the operating efficiencies, including market efficiencies, of IE COM.
- b. It will increase the appeal to present and potential customers because of IE COM's larger size and greater variety of service offerings as well as enhance the ability of IE COM to appeal to and serve national accounts.
- c. It will result in cost savings as the result of discounts on quantity ordering of materials and services.
- d. Accordingly, the Acquisition and subsequent consolidation will serve to create a heightened level of operating efficiency which generally will serve to enhance the overall capacity of IE COM to compete in the marketplace and to provide telecommunications services for a greater number of consumers of this State at competitive rates.
- e. Additionally, IE COM will possess a larger customer base as the result of the Acquisition, and will thus be a stronger carrier to provide high quality service to all customers presently serviced by both IE COM and NOSVA.

V. EXPEDITED REVIEW

13. Applicants request expedited review and disposition of the instant Application in order to allow Applicants to consolidate their respective operations as soon as possible.

VI. NO TRANSFER OF CERTIFICATES

14. Applicants do not request transfer of NOSVA's Certificate of Public Convenience and Necessity, or other operating authority, to IE COM.

VII. CONCLUSION

15. WHEREFORE, for the reasons stated herein, Applicants respectfully request that the Commission authorize IE COM and NOSVA to consummate the Agreement described above. More specifically, Applicants request that the Commission, on an expedited basis, approve the Agreement, the Acquisition contemplated therein and the transfer of the Customer Accounts to IE COM.

DATED this 8th day of February, 2000.

Respectfully submitted,



EllenAnn G. Sands
Nowalsky, Bronston & Gothard
A Professional Limited Liability Company
3500 North Causeway Boulevard
Suite 1442
Metairie, Louisiana 70002
(504) 832-1984
Counsel for International Exchange Communications,
Inc. ("IE COM") and NOSVA Limited Partnership
("NOSVA")

Danny E. Adams
Kelley, Drye & Warren, LLP
1200 19th Street, N.W., Suite 500
Washington, DC 20036
(202) 955-9600
Counsel for NOSVA Limited Partnership ("NOSVA")

STATE OF NEVADA
COUNTY OF CLARK

VERIFICATION

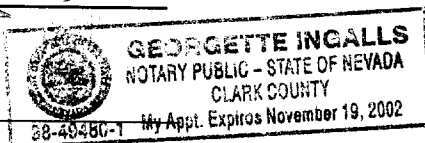
I, Michael Arnau, am the Chief Executive Officer of NOSVA Limited Partnership, and am authorized to make this verification on its behalf. The statements made in the foregoing Application are true of my own knowledge, except as to those matters which are therein stated on information and belief, and as to those matters I believe them to be true.

By: Michael Arnau
Name: Michael Arnau
Title: Chief Executive Officer

Sworn to and subscribed before me, Notary Public, in and for the State and County named above, this 27 day of January, 2000

Georgette Incalls
Notary Public

My commission expires:



STATE OF California
COUNTY OF San Mateo

VERIFICATION

I, Sandra Grey, am the CFO/Vice President-Finance of International Exchange Communications, Inc., and am authorized to make this verification on its behalf. The statements made in the foregoing Application are true of my own knowledge, except as to those matters which are therein stated on information and belief, and as to those matters I believe them to be true.

By: [Signature]
Name: Sandra Grey
Title: Vice President/Finance - CFO

Sworn to and subscribed before me, Notary Public, in and for the State and County named above, this 26 day of January, 2000

[Signature]
Notary Public

My commission expires: December 14, 2001

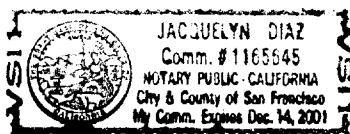


Exhibit "A"
Asset Purchase Agreement

ASSET PURCHASE AGREEMENT

THIS ASSET PURCHASE AGREEMENT (the "Agreement") is made and entered into as of the day of between **International Exchange Communications, Inc.**, a Delaware corporation ("**Purchaser**"), and **NOSVA Limited Partnership**, a Maryland limited partnership ("**Seller**").

WHEREAS, Seller conducts business as a reseller of long distance telecommunications services and has established a customer base and related assets which it now desires to sell; and

WHEREAS, Purchaser desires to purchase the customer base and related assets of Seller on the terms and subject to the conditions of this Agreement.

NOW, THEREFORE, in consideration of the foregoing and the mutual promises, covenants, representations and warranties herein contained, it is hereby agreed as follows:

1. Sale and Transfer of Assets

1.1 Assets to be Sold

Subject to the terms and conditions set forth in this Agreement, Seller agrees to sell, convey, transfer, assign and deliver to Purchaser, and Purchaser agrees to purchase from Seller, all of Seller's right, title and interest in and to the following assets of Seller (the "**Assets**") excluding accounts receivable, unbilled call records, cash, bank accounts, marketable securities, corporate records, tax refunds and claims of Seller against others for damages:

(a) the "**Customer Related Assets**," comprised of (1) Seller's international operating division which markets under the brand names "International Plus" and "011 Communications" (the "**Business**") and all residential (as defined by the applicable local exchange carrier or the competitive local exchange carrier) international end user long distance telecommunications customer accounts thereof (but specifically excluding business customer accounts) which are listed in an electronic format satisfactory to Purchaser (which electronic format shall include all present and former customer accounts, whether currently active or inactive, in existence as of the Closing Date) (the "**Customer Accounts**") (the end users of the long distance telecommunications services that generate the Customer Accounts shall be hereinafter referred to as the "**Customers**"); (2) all of Seller's rights under any agreements, application forms, term contracts, letters of agency and all other contractual instruments between Seller and any and all Customers related to the Customer Accounts (collectively, the "**Customer Contracts**"), including but not limited to Seller's right to assert claims and take other rightful actions in respect of breaches, defaults and other violations of such Customer Contracts; (3) all customer and other deposits held or made by Seller related to the Customer Accounts; and (4) all relationships and goodwill related to the Customer Accounts; and

(b) the following assets (the "**Non-Customer Assets**");

(i) all of Seller's rights in those contracts set forth on Schedule 1.1(b)(i) (collectively, the "**Non-Customer Contracts**");

(ii) all of Seller's current toll-free numbers used by and in the Business for customer service in accordance with Section 2.3(f);

(iii) the Intellectual Property (as hereinafter defined);

(iv) all leases, leasehold interests, equipment, furniture, fixtures, computers, telephones and other tangible, intangible, real and personal property occupied and/or utilized by and in the Business, to the extent set forth in Schedule 1.1(b)(iv) and specifically including any and all lead lists utilized in the Business;

(v) to the extent allowable under applicable laws, rules and regulations, carrier identification code (CIC) number 210; and

(vi) the local service customer accounts of NOS Communications Inc. which accompany certain of the long distance customer accounts of Seller ("the Local Customers").

1.2 NOS

Subject to the terms and conditions set forth in this Agreement, Seller hereby agrees to cause NOS Communications, Inc. ("NOS") to sell, convey, transfer, assign and deliver to Purchaser all of NOS's right, title and interest in and to the Intellectual Property (as hereinafter defined) and the Local Customers.

1.3 CIC Code

Purchaser and Seller agree that in the event CIC number 210 cannot be transferred to Purchaser as contemplated in Section 1.1(b)(v) above, then the Cash Purchase Price (as hereafter defined) shall be reduced by an amount equal to (a) _____ (b) the actual cost up to _____ of moving the customers to another CIC number, which aggregate amount shall be deducted from the payment due pursuant to Section 2.3(b)(iii) below.

2. The Closing

2.1 Place and Date

The closing of the purchase and sale of the Assets (the "**Closing**") shall take place at the offices of Purchaser located at 533 Airport Boulevard, Suite 505, Burlingame, California 94010, at or before _____, local time, as soon as reasonably practicable after the conditions set forth in **Section 7** hereof have been satisfied but in no event later than _____. The date of the Closing is herein referred to as the "**Closing Date**."

2.2 Transfer of Assets

(a) At the Closing and subject to the terms and conditions of this Agreement, Seller shall deliver to Purchaser the following, and simultaneously with such delivery, Seller shall take such action as may be necessary or reasonably requested by Purchaser to place Purchaser in possession and control of the Assets:

(i) Such bills of sale, assignments, novation agreements, master letters of agency or other instruments of transfer and assignment as shall be necessary to vest in Purchaser title to the Assets sold and assigned under this Agreement, free and clear of all liens, claims and encumbrances;

(ii) Copies of Seller's partnership resolutions authorizing the execution, delivery and performance of this Agreement by Seller and a certificate of Seller's general partner dated the Closing Date, that such resolutions were duly adopted and are in full force and effect;

(iii) A current list (in electronic format) of the Customer Accounts to be transferred and an aging report for all accounts receivable ("**Accounts Receivable**") associated with and derived from such Customer Accounts; and

(iv) Such other certificates or other documents or instruments as the Purchaser or Purchaser's counsel may reasonably request.

(b) At the Closing, as a condition to Seller's obligations under this Agreement, Purchaser shall deliver to Seller the following:

(i) All instruments as may be reasonably necessary by which Purchaser assumes the obligations and liabilities to be assumed by it hereunder;

(ii) Copies of resolutions of the Board of Directors of Purchaser authorizing the execution, delivery and performance of this Agreement by Purchaser, including, without limitation, the issuance (if applicable) of the Purchase Price Shares (as hereinafter defined) by Pacific Gateway Exchange, Inc. ("PGE"), and a certificate of Purchaser's secretary, dated the Closing Date, that such resolutions were duly adopted and are in full force and effect;

(iii) That portion of the Purchase Consideration (as hereinafter defined) due on the Closing Date, including duly issued certificates representing the Purchase Price Shares (if applicable);

(iv) Reimbursement of the Security Deposits set forth in Schedule 1.1(b)(i);
and

(v) Such other certificates or other documents or instruments as Seller or Seller's counsel may reasonably request.

2.3 **Purchase Consideration; Adjustments; Earn-Out; Integration**

(a) The purchase consideration to be paid by Purchaser to Seller for the Assets shall be:

(i) in cash (the "**Cash Purchase Price**"); and

(ii) The Purchase Price Shares described in Section 2.3(c) below.

- (iii) The purchase consideration described in this Section 2.3(a) shall be referred to hereinafter, as adjusted, as the **"Purchase Consideration."**
- (b) The Cash Purchase Price shall be paid as follows:
- (i) on or before _____, Purchaser shall pay to Seller _____ in cash (hereinafter, the **"Breakup Cash"**) which shall constitute a non-refundable deposit which Seller shall retain sole and absolute ownership of notwithstanding any termination of this Agreement;
 - (ii) at the Closing, Purchaser shall pay to Seller _____ in cash;
 - (iii) on or before the close of business on the ninetieth (90th) day following the Closing Date, Purchaser shall pay to Seller _____ in cash; and
 - (iv) on or before the close of business on the one hundred eightieth (180th) day following the Closing Date, Purchaser shall pay to Seller _____ in cash.

The Cash Purchase Price shall be payable in immediately available funds by wire transfer in accordance with the instructions delivered in writing by Seller to Purchaser.

(c) The Purchase Price Shares (as hereafter defined) shall be issued in accordance with the following:

- (i) on or before _____, Purchaser shall issue to Seller that number of shares (the **"Breakup Shares"**) of common stock, par value \$.0001 per share, of PGE (**"PGE Common Stock"**) in an amount equal to _____ (the **"Breakup Share Amount"**) in the event Purchaser, in the course of conducting its due diligence review of the Business, from the date of this Agreement through and including _____, does not learn of any gross misrepresentations of Seller contained herein (**"Gross Misrepresentations"**). In the event Purchaser does learn of such Gross Misrepresentations, Purchaser shall elect to either (i) provide written notice of the nature of the Gross Misrepresentations to Seller and in such notice elect to terminate this Agreement (the **"Termination Notice"**) or (ii) provide Seller with written notice waiving such Gross Misrepresentations and elect to proceed with the transactions contemplated by this Agreement (the **"Waiver Notice"**). In the event Seller receives the Termination Notice, then this Agreement shall terminate provided that Seller shall have the right to dispute pursuant to Section 9.13 whether there were in fact any such Gross Misrepresentations and if Seller successfully disputes such fact then Purchaser shall forthwith upon receipt of the final decision of the arbitrator cause the Breakup Shares to be delivered to Seller. Termination of this Agreement pursuant to the Termination Notice and retention of the Breakup Shares shall be

Purchaser's sole and exclusive remedy for a Gross Misrepresentation and Purchaser shall have no other liability or obligation to Seller under this Agreement. In the event (i) Purchaser is satisfied with the due diligence review of the Business, it shall provide Seller with a notice of satisfaction on or before (the "**Satisfaction Notice**") or (ii) Purchaser provides Seller with a Waiver Notice, then in either such event Purchaser shall concurrently deliver the Breakup Shares to Seller. In the event Purchaser receives the Breakup Shares pursuant to the terms of this Agreement, then the Breakup Shares shall constitute a non-refundable deposit which Seller shall retain sole and absolute ownership of notwithstanding any termination of this Agreement.

- (ii) On or before the Closing Date, Purchaser shall issue to Seller that number of shares PGE Common Stock in an amount equal to (the foregoing amount plus the Breakup Share Amount shall be referred to hereinafter as the "**Stock Purchase Price**") minus (A) (the "**Earn-Out Amount**") and also minus (B) (the "**Additional Amount**").
- (iii) That number of shares of PGE Common Stock representing the Earn-Out Amount shall be referred to hereinafter as the "**Earn-Out Shares**." Purchaser shall cause the Earn-Out Shares, as adjusted pursuant to this Section 2.3(c)(iii), to be delivered to Seller on Following the Closing, Seller is to manage the Business for Purchaser pursuant to the Management Agreement (as hereinafter defined). The amount of the Earn-Out Shares to be delivered to Seller are to be reduced in the following manner in the event the gross revenues of the Business (as determined by generally accepted accounting principles) (the "**Gross Revenues**") are less than Dollars (the "**Maximum Amount**") in the aggregate during the period of through and including (the "**Earn-Out Period**"): (A) in the event the Gross Revenues during the Earn-Out Period are less than (the "**Minimum Amount**") Seller shall be entitled to no Earn-Out Shares and (B) in the event the Gross Revenues during the Earn-Out Period are more than the Minimum Amount but less than the Maximum Amount then the Earn-Out Amount (and the corresponding number of Earn-Out Shares) shall be reduced by an amount equal to (I) the Earn Out Amount times (II) the Maximum Amount less the Gross Revenues, divided by (III)

(the "**Difference Amount**"). Notwithstanding the foregoing, in the event the Closing Date occurs prior to then the Maximum Amount shall be , the Minimum Amount shall be , the Difference Amount shall be and the

Earn-Out Period shall commence on the Closing Date and end on the date one hundred eighty (180) days later.

- (iv) That number of shares of PGE Common Stock representing the Additional Amount shall be referred to hereinafter as the “**Additional Shares.**” On or before the earlier of (A) the one hundred eightieth (180th) day following the Closing Date or (B) the fifteenth (15th) day occurring after completion of the first full calendar month billing cycle (the “**First Cycle**”) following integration of the Purchaser’s customer accounts pursuant to Section 6.12 hereof, Purchaser shall pay to Seller the Additional Shares; provided, however, in the event that in respect of such customer accounts (excluding casual calling traffic) Seller has billed during the First Cycle less than seventy percent (70%) of the gross revenues (as determined according to generally accepted accounting principles) billed by Purchaser in respect of such accounts (excluding casual calling traffic) during the last full billing cycle prior to the Closing Date (the “**Last Cycle**”) then the Additional Amount (and the corresponding number of Additional Shares to be issued pursuant to this paragraph) shall be reduced to an amount equal to (A) times (B) (1) the actual gross revenues billed during the First Cycle divided by (2) the actual gross revenues billed during the Last Cycle.
- (v) Purchaser hereby agrees to use its best efforts to register any shares of PGE Common Stock issued to Seller pursuant to Sections 2.3(c)(i), (ii), (iii) or (iv) (collectively, the “**Purchase Price Shares**”), at its sole cost and expense, under the Securities Act of 1933, as amended (the “**Securities Act**”), as soon as practicable after the respective dates of issuance of the PGE Common Stock but in no event later than five (5) business days after such issuance date. PGE agrees to use reasonable commercial efforts to keep the registration statement regarding the re-sale of such shares effective under the Securities Act until the earliest to occur of the following: (A) all shares received by Seller have been sold; (B) all shares can be sold in a three (3) month period under Rule 144 of the Securities Act; or (C) five hundred forty-five (545) days after the Closing. Seller agrees to cooperate with PGE regarding the sale of such shares.
- (vi) The parties hereby agree that, in calculating the number of Purchase Price Shares to be issued pursuant to Sections 2.3(c)(i), (ii), (iii) or (iv), the average of the closing bid and ask price per share for the 20 trading days immediately preceding the relevant date of issuance to Seller shall be used.
- (vii) The parties hereby agree that Purchaser, in its sole discretion, may substitute cash, in lieu of shares of PGE Common Stock, for all or any portion of the Purchase Price Shares prior to the issuance of those shares to Seller pursuant to the terms of this Agreement. If Purchaser elects to so substitute cash for all of the Purchase Price Shares, the parties shall be

relieved of their obligations under the Stock Sale Agreement (as hereafter defined). In addition, Purchaser shall have the right at any time within the period of one hundred eighty (180) days following (A) the date of delivery to Seller of the Earn-Out Shares or the Additional Shares, in the case of such shares or (B) the Closing Date, in the case of all other PGE Common Stock constituting Purchase Consideration, to elect to repurchase from Seller any such PGE Common Stock issued to Seller. The repurchase price shall be calculated based on the average of the closing bid and ask price per share for the 20 trading days immediately preceding the relevant repurchase date (the "**Average Price**"). In the event the Average Price is equal to or less than one hundred percent (100%) of the per share portion of the Stock Purchase Price attributable to the PGE Common Stock to be repurchased by Purchaser (the "**Base Price**") then the repurchase price shall be the Base Price. In the event the Average Price is equal to or more than one hundred twenty-five percent (125%) of the Base Price then the repurchase price shall be one hundred twenty-five percent (125%) of the Base Price. In the event the Average Price is less than one hundred twenty-five percent (125%) and more than one hundred percent (100%) of the Base Price then the repurchase price shall be the Average Price. The repurchase price shall be paid in cash and shall be delivered to Seller within three (3) business days of Purchaser's election to repurchase. Seller shall concurrently deliver the relevant shares of PGE Common Stock to Purchaser.

- (viii) The number of shares of PGE Common Stock received by Seller shall not be subject to adjustment except if the Seller sells such shares at any time within the period of one hundred eighty days (180) following (A) the date of registration under the Securities Act and delivery to Seller of the Earn-Out Shares or the Additional Shares (in the case of such shares), or (B) the Closing Date in the case of all other PGE Common Stock constituting Purchase Consideration, then in the event (1) the sale price for such shares is less than ninety percent (90%) of the portion of the Stock Purchase Price attributable to those particular shares, Purchaser shall pay to Seller an amount equal to the difference between ninety percent (90%) of the portion of the Stock Purchase Price attributable to the particular shares sold by Seller and the sale price received by Seller in respect of those shares and (2) the sale price for such shares is more than one hundred twenty-five percent (125%) of the portion of the Stock Purchase Price attributable to those particular shares, Seller shall pay to Purchaser an amount equal to the difference between one hundred twenty-five percent (125%) of the portion of the Stock Purchase Price attributable to the particular shares sold by Seller and the sale price received by Seller in respect of those shares. The parties shall effect such adjustments on weekly intervals commencing one week after the Closing.
- (ix) The 545 day period set forth in Section 2.3(c)(v), and the 180 day period set forth in Section 2.3(c)(vii), shall each be extended by the length of any



Delay Period (as such term is defined in the Stock Sale Agreement, the form of which is attached hereto as Exhibit 6.8)

(d) A list of Non-Customer Contracts which Purchaser desires to acquire from Seller and assume at Closing is set forth in Schedule 1.1(b)(i) attached hereto. In the event the counterparty to any such Non-Customer Contract fails or refuses to allow the transfer of same to Purchaser prior to the Closing Date, then Seller shall, at Purchaser's sole option and in Purchaser's sole discretion, provide the service or function which is the subject of such Non-Customer Contract on the same terms and conditions as contained therein.

(e) Purchaser agrees to (i) service all Customer Accounts and (ii) perform all Non-Customer Contracts acquired and assumed by Purchaser pursuant to this Section 2.3(d) and Purchaser further agrees to indemnify and hold harmless Seller from and against any claims relating to Purchaser's performance, or failure to perform, such Customer Accounts and Non-Customer Contracts subsequent to the Closing Date.

(f) Seller utilizes the toll-free numbers for its customer service set forth on Schedule 2.3(f). At Closing, Seller shall assign to the Purchaser all of Seller's right, title and interest in and to all such toll-free numbers, and, to the extent that Seller is not the owner of the toll-free number which is manned by any other entity, Seller shall utilize commercially reasonable efforts to persuade such entity to assign its interests in such toll-free number to Purchaser.

(g) Purchaser acknowledges that Seller does not maintain copies of all verification records with respect to the Customer Accounts and that many of such records may be in the possession of one or more companies that provide verification services to Seller. In lieu of delivering all such verification records to Purchaser at Closing, Purchaser agrees that Seller may provide at Closing a letter addressed to each such verification company directing such verification company to hold all verification records relating to Customer Accounts at the direction of Purchaser.

(h) Two days prior to the Closing Date, Seller shall deliver to Purchaser an aging of all accounts payable ("**Accounts Payable**") of the Business on an itemized basis.

(i) Two days prior to the Closing Date, Seller shall deliver to Purchaser an aging of all accounts receivable of the Business on an itemized basis.

(j) In the event applicable laws, rules or regulations require any Authorizations to be transferred to Purchaser in order to consummate the transactions contemplated herein, Seller shall have the option to elect to (i) transfer such Authorizations or (ii) exclude from the Assets the Customer Accounts derived from Customers located in the particular state(s) requiring the transfer of such Authorizations. In the event Seller elects to exclude such Customer Accounts, the Stock Purchase Price shall be reduced by an amount equal to (A) Thirty-Five Million Dollars (\$35,000,000), times (B) the portion of the gross revenues (determined by generally accepted accounting principles) of the Business during the month immediately preceding the Closing Date derived from Customers located in the state(s) requiring the transfer of such Authorizations, divided by (C) the total gross revenues of the Business during such preceding month.

(k) Purchaser agrees to use its best efforts to resolve any matters necessary in order to obtain approval for the transactions contemplated herein from the Federal Communications Commission ("FCC") and all applicable state public service and/or utility commissions (collectively, "PSCs"), including, without limitation, the payment of any fees or taxes in connection therewith, provided however, that Seller shall forthwith pay any and all fees or taxes relating to the Business which have accrued but have not been paid as of the Closing Date.

(l) The allocation of the Purchase Consideration shall be determined prior to the Closing Date. Following execution of this Agreement, Seller and Purchaser shall exercise their best efforts to agree upon such allocation. In the event Seller and Purchaser are unable to reach such agreement, then either party shall be entitled to request that the allocation be determined by the accounting firm of Arthur Andersen. The parties shall equally bear all costs, expenses and charges of Arthur Andersen resulting from such determination; provided however Purchaser shall pay any such costs, expenses and charges in excess of Twenty Thousand Dollars (\$20,000). Arthur Andersen shall provide each of the parties written notice of its determination which shall be final and binding unless one of the parties delivers written notice of dispute to the other party within seven (7) days of receipt of such determination. In the event of such dispute, the matter shall be referred to final and binding arbitration pursuant to Section 9.13 of this Agreement.

(m) All payments received by Seller (whether in its capacity as manager pursuant to the Management Agreement or otherwise) from Customers after the Closing in respect of accounts receivable of the Business shall be allocated on a first in first out basis in accordance with generally accepted accounting principles.

2.4 Limitation on Assumption of Liabilities.

Except for (i) the Customer Accounts and (ii) the Non-Customer Contracts specifically assumed by Purchaser pursuant to Section 2.3(d) above, Purchaser shall not be liable for any of the obligations or liabilities of Seller of any kind or nature. Seller shall pay, perform and discharge all of the other valid liabilities and obligations related to the Business which have not been assumed by Purchaser pursuant to this Agreement and shall specifically indemnify and hold harmless Purchaser from and against same. Purchaser shall pay, perform and discharge all of the valid liabilities and obligations related to the Business which have been assumed by Purchaser pursuant to this Agreement and shall specifically indemnify and hold harmless Seller from and against same.

3. Representations and Warranties of Seller

Seller represents and warrants to Purchaser as follows, which representations and warranties are made as of the date hereof and as of the Closing Date and shall survive the Closing for a period of one year (except with respect to the representations and warranties in Section 3.6 which shall survive for two years):

3.1 Organization

(a) Except as set forth on Schedule 3.1(a) attached hereto Seller is a limited partnership duly organized, validly existing and in good standing under the laws of the State of Maryland, is duly qualified and in good standing as a foreign limited partnership in the states set

forth on **Schedule 3.1(a)** attached hereto with full requisite legal power and authority to own its properties and assets and to carry on lawfully its business as currently conducted, and is not required to be qualified to do business as a foreign limited partnership in any other jurisdiction, except for those jurisdiction(s) where the failure to be so qualified would not have a material adverse effect on the Business.

(b) Seller does not have any subsidiaries and neither owns nor holds any securities of, or any interest in, any other person or entity and is not a partner or member in or subject to any joint venture, partnership, limited liability company or other arrangement or contract that is or could be treated as a partnership for federal income tax purposes, in each case, other than de minimus interests in publicly traded entities.

3.2 Authorization

Seller has all requisite partnership power and authority to enter into this Agreement and to carry out the transactions contemplated by this Agreement. The execution, delivery and performance by Seller of this Agreement and the other agreements and documents referred to herein and therein and the actions contemplated hereby and thereby have been duly and validly authorized by all necessary partnership action on the part of Seller, and this Agreement and such other agreements and documents constitute valid and binding obligations of Seller, enforceable in accordance with their terms, subject to (i) general principles of equity, regardless of whether enforcement is sought in a proceeding in equity or at law, and (ii) bankruptcy, reorganization, insolvency, fraudulent conveyance, moratorium, receivership or other similar laws relating to or affecting creditors' rights generally.

3.3 Liabilities

Except as set forth in Schedule 3.3 attached hereto, and subject to obtaining the Consents (as herein defined) and the consents of the counter parties to the assignment of the Non-Customer Contracts, Seller has no obligations or liabilities, whether direct or indirect, joint or several, absolute or contingent, matured or unmatured, secured or unsecured, which could be affected by the execution and delivery of this Agreement or consummation of the transactions contemplated by this Agreement or which could affect the same.

3.4 Title to and Condition of Assets and Property

At Closing, Seller shall deliver to Purchaser good and marketable title to the Assets free and clear of all liens, claims, charges, security interests, options, or other title defects or encumbrances except as otherwise disclosed pursuant to this Agreement. Except as set forth in Schedule 1.1(b)(i) attached hereto, the Assets contain no real or personal property currently leased or otherwise occupied or used, but not owned, by Seller. All property owned or leased by Seller in connection with the Business constitute all of the assets currently used or needed in the ongoing operation of the Business as it is currently operated other than the contracts listed on **Schedule 3.6**. Except as set forth in Schedules 3.1(a) and 3.7 attached hereto, the operations which constitute the Business conform with all applicable federal, state and local laws, ordinances, rules and regulations except to the extent that any such non-compliance does not have a material adverse effect on the Business.

3.5 Intellectual Property

Set forth on **Schedule 3.5** hereto is a complete list of any and all trade names and trademarks being transferred to Purchaser in respect of the Business (the “**Intellectual Property**”). To the best of Seller’s knowledge, the use of the Intellectual Property by Seller does not infringe on the rights of any person who has ever been employed by Seller since its inception.

3.6 Contracts

Except for Customer Contracts, Non-Customer Contracts, contracts between Seller and its affiliates, or as set forth in **Schedule 3.6** attached hereto, Seller is not a party to or bound by any contract or agreement, written or oral with a person or entity which is material to the Business.

Neither Seller nor, to the best of Seller’s knowledge any other party to any Non-Customer Contract, has breached any provisions of, or is in violation or default under the terms of, or has caused or permitted to exist any event that with or without due notice or lapse of time or both would constitute a default or event of default under, any such Non-Customer Contract. There are no facts or circumstances which have arisen on or prior to the date hereof which could lead to any additional obligation under any of the Non-Customer Contracts (payment or otherwise) or to the violation, cancellation or other early termination of one or more of the Non-Customer Contracts. All Non-Customer Contracts are valid, binding and in full force and effect and will continue in full force and effect to the benefit of Seller, its respective successors and assigns, if such party so elects, without change following the consummation of the transactions contemplated by this Agreement if assigned to Purchaser in accordance with Section 2.3(d) hereof. The consummation of the transactions contemplated by this Agreement will not violate or cause a default or event of default under any provision of, or result in the acceleration of any obligation under, or the termination of, any Contract.

3.7 Litigation and Compliance

Except as set forth in Schedule 3.7 attached hereto: (i) There is no pending or, to the knowledge of Seller, threatened claim, investigation, lawsuit or administrative proceeding by or against Seller with respect to the Business; (ii) the Business is in compliance with all federal, state, local and foreign laws and regulations and administrative orders and all tariffs, rules and regulations of local exchange carriers and inter-exchange carriers applicable thereto except to the extent that any such non-compliance does not have a material adverse effect on the Business, and (iii) there is no order, writ, injunction or decree relating to or affecting the Business or the transactions contemplated by this Agreement.

3.8 Non-Contravention

Except as set forth in Schedule 3.3 attached hereto, neither the execution of this Agreement nor the consummation of the transactions contemplated hereby will result in the breach of any term or provision of, constitute a default under, or accelerate or augment the performance otherwise required under, any provision of the partnership agreement of Seller, or any material agreement (including without limitation any loan agreement or promissory note),



indenture, instrument, order, law or regulation to which Seller is a party or by which it is bound, or will result in the creation of any lien or encumbrance upon any of the Assets.

3.9 Licenses, Permits and Required Consents

Set forth on **Schedule 3.9** attached hereto is a list of all material federal, state, local and foreign franchises, tariffs, licenses, ordinances, certifications, approvals, authorizations and permits (collectively, the “**Authorizations**”) necessary for Seller to conduct and operate the Business as currently conducted. All Authorizations relating to the Business are in full force and effect, no violations have been made in respect thereof, and, other than those customer complaints and descriptions thereof set forth in Schedule 3.7 attached hereto, no proceeding is pending or, to the knowledge of Seller, threatened which could have the effect of revoking or limiting any such Authorizations, and the same will not cease to remain in full force and effect by reason of the transactions contemplated by this Agreement. Seller shall exercise its best efforts to file or obtain all FCC and PSC registrations, filings, applications, notices, transfers, consents, approvals, orders, qualifications, authorizations, certifications, waivers or other actions of any kind required to be made, filed, given or obtained by or on behalf of Seller with, to or from the FCC and PSCs in connection with the consummation of the transactions contemplated by this Agreement (“**Consents**”).

3.10 Disclosure

No representation, warranty or statement made by or on behalf of Seller in this Agreement or the Schedules attached hereto or in the certificates or other materials furnished or to be furnished to Purchaser or its representatives prior to the Closing in connection with this Agreement and the transactions contemplated hereby or thereby, contains or will contain any untrue statement of material fact or omits or will omit to state a material fact required to be stated herein or therein or necessary to make the statements contained herein or therein not misleading.

3.11 Brokers

Seller has not engaged any investment banker, financial advisor or broker of any kind with respect to the sale of the Assets and no fee or other compensation shall become payable to any investment banker, financial advisor or broker of any kind, engaged by Seller, upon the closing of the transactions contemplated hereby.

3.12 Due Diligence

Seller shall use best efforts to comply in full in responding to the due diligence requests of the Purchaser through and including _____ (provided that Seller shall not be required to permit due diligence requests and review which materially interfere with Seller's business).

3.13 Investment Representations

Seller represents and warrants to Purchaser that it is acquiring the Purchase Price Shares registered in its name for its own account and not with a view to dividing PGE Common Stock with others or participating directly or indirectly in any resale, distribution or underwriting

thereof and will not transfer or assign PGE Common Stock in violation of the Securities Act, applicable state securities laws or this Agreement. Seller further represents and warrants that it is able to bear the economic risk of the investment in PGE Common Stock and has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of such investment. Seller shall provide such information and execute such documents as Purchaser may reasonably request in order to verify the foregoing. Seller acknowledges that it has been provided an opportunity to ask questions and receive answers from Purchaser and PGE concerning the terms and conditions of the offering of PGE Common Stock and to obtain any additional information which Purchaser possesses or can acquire without unreasonable effort or expense that is necessary to verify the accuracy of any information furnished in connection with said offering.

3.14 Customer Account Materiality

No single Customer Account comprises more than one percent (1%) of the Business.

3.15 Disclaimer of Fraudulent Intent

Seller represents and warrants that the transactions described in this Agreement have been undertaken in good faith, considering their obligations to any person or entity to whom Seller owes a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured (collectively such persons with such claims are called "**Seller Creditors**" under this paragraph), and has undertaken these transactions without any intent to hinder, delay or defraud any such Seller Creditors, and either has disclosed in the ordinary course of business or will undertake to disclose to all such Seller Creditors (if required by applicable laws rules or regulations) the existence of this transaction. Seller further represents and warrants that: (1) neither Seller, nor any current or former employees of Seller or any of Seller's corporate affiliates will retain possession or control of any of the property transferred under this Agreement following the Closing, except as expressly provided in this Agreement or any agreement executed in connection herewith and then only for and on behalf of the account of the Purchaser; (2) Seller has not been sued or threatened with suit by any Creditor relative to the Business prior to the execution of this Agreement; (3) Seller has not removed or concealed any assets from any Seller Creditors; and (4) Seller believes in good faith that, at Closing, Seller will receive consideration reasonably equivalent to the value of the Assets transferred under this Agreement.

3.16 Protection of Customer Accounts

Seller represents and warrants that it has used its best efforts to ensure that all information related to the Customer Accounts, including, but not limited to, all customer lists, mailing lists, books, records, files, data, and letters of agency, has not been disclosed to anyone other than employees, directors and agents of Seller and any of Seller's corporate affiliates and that no such employees, directors or agents will possess, control or otherwise have any right to such information following the Closing of the transaction contemplated hereby.

4. Representations and Warranties of Purchaser

Purchaser represents and warrants to Seller as follows:

4.1 Corporate Status

Purchaser is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware with full corporate power and authority to carry on its business as now conducted.

4.2 Authority for Agreement

Purchaser has the power and authority to execute and deliver this Agreement and to carry out its obligations hereunder. The execution, delivery and performance by Purchaser of this Agreement and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of Purchaser. This Agreement has been duly executed by Purchaser and the transactions contemplated by them constitute the legal, valid and binding obligation of Purchaser enforceable against Purchaser in accordance with its terms. No consent, approval, or authorization of, or declaration, filing, or registration with, any federal or state governmental or regulatory authority is required to be made or obtained by Purchaser in connection with the execution, delivery, and performance of this Agreement and the consummation of the transactions contemplated by this Agreement, except approval of applicable public service commissions.

4.3 No Conflicts

To the best of Purchaser's knowledge, the execution, delivery and performance of this Agreement and the consummation of all of the transactions contemplated hereby: (i) do not and will not with or without the giving of notice or passage of time or both, violate, conflict with or result in a breach or termination of any provision of, or constitute a default under, or accelerate or permit the acceleration of the performance required by the terms of, or result in a creation of any mortgage, security interest, claim, lien, charge or other encumbrance upon any of its assets pursuant to, or otherwise give rise to any liability or obligation under any agreement, mortgage, deed of trust, license, permit or other agreement or instrument, or any order, judgment, decree, statute, regulation or any other restriction of any kind or description to which Purchaser is a party or by which Purchaser or its assets may be bound; and (ii) will not terminate or result in the termination of any such agreement or instrument, or in any way affect or violate the terms and conditions of, or result in the cancellation, modification, revocation or suspension of, any rights in or to its assets.

4.4 Disclosure

The representations, warranties and statements made by Purchaser in this Agreement and in the certificates and other documents delivered pursuant hereto do not contain any untrue statement of a material fact, and, when taken together, do not omit to state any material fact necessary to make such representations, warranties and statements, in light of the circumstances under which they are made, not misleading.



4.5 SEC Filings and Financial Information

PGE, the owner of 100% of the capital stock of Purchaser, has filed with the Securities and Exchange Commission (the "**Commission**") its Annual Report on Form 10-K for the year ended December 31, 1998, together with all schedules and exhibits attached thereto, and Quarterly Reports on Form 10-Q for the quarters ended March 31, 1999, June 30, 1999 and September 30, 1999 (collectively, the "**SEC Documents**"). Each SEC Document, as of the date of its filing thereof with the Commission, conformed in all material respects with the requirements of the Exchange Act, and the rules and regulations thereunder. The financial statements of PGE, including the notes thereto, included in the SEC Documents complied as to form in all material respects with applicable accounting requirements and with the published rules and regulations of the Commission with respect thereto, have been prepared in accordance with GAAP consistently applied (except as may be indicated in the notes thereto) and present fairly the consolidated financial position of PGE at the dates thereof and of its operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to normal audit adjustments). Since the date of PGE's last Report on Form 10-Q, there have been no contracts, loss contingencies, acquisitions or divestitures that are material to PGE that have not been disclosed to Seller.

4.6 Purchase Price Shares

If Purchase Price Shares are issued pursuant to this Agreement, said Purchase Price Shares shall be (i) fully paid, nonassessable and free and clear of all liens, encumbrances, pledges, charges and security interests, (ii) shall be "restricted shares" under Rule 144 promulgated by the Securities Exchange Commission under the Securities Act, (iii) not subject to any shareholder's agreement, voting trust or other similar agreement, and (iv) are entitled to the protections set forth in Section 6.8 hereof.

5. Seller's Obligations Before Closing

Seller covenants that from the date of this Agreement and until the Closing Date:

(a) Through and including _____, Purchaser and its counsel, accountants and other representatives shall have full access to all properties, books, accounts, records, contracts and documents of or relating to the Business (including, but not limited to, billing records, customer service history, verbal letters of agency tapes or written letters of agency where required), but Purchaser shall not have access to any information not related to the Business. Through and including _____, Seller shall furnish or cause to be furnished to Purchaser and its representatives all data and information concerning the Business that may be reasonably requested.

(b) Seller will continue to operate the Business diligently and in substantially the same manner as prior to this Agreement and shall not take any actions that vary materially from those methods used by Seller in the operation of the Business as of the date of this Agreement, without the prior written consent of Purchaser.

6. Covenants

6.1 Further Assurances

At any time and from time to time after the Closing Date, each party shall, without further consideration, execute and deliver to the other such other instruments of transfer and assumption and shall take such other action as the other may reasonably request to carry out the transfer of the Assets and the assumption of the specific liabilities contemplated by this Agreement; provided, however, Purchaser shall pay the reasonable out of pocket expenses incurred by Seller in taking any actions requested by Purchaser after the Closing.

6.2 Standstill; Public Announcement

Prior to the Closing or termination of this Agreement, Seller agrees not to directly or indirectly solicit, entertain or encourage offers or negotiate with any other person or entity regarding the purchase or sale of the Business. The foregoing shall not prohibit Seller from selling some or all of its business and operations to a third party, provided that such third party honors and fulfills all obligations, duties and commitments of Seller set forth herein and in such other agreements executed in connection herewith. Seller shall not make any public announcement with respect to the subject matter of this Agreement. Purchaser shall not make any public announcement with respect to the subject matter of this Agreement without Seller's prior consent, which consent shall not be unreasonably withheld; provided however Seller shall be entitled to withhold its consent to any press release that would have a material adverse impact on Seller or the Business. Notwithstanding any provision of this Section 6.2 to the contrary, Purchaser and PGE may make any public disclosure about this Agreement to the extent required in the opinion of its counsel by federal or state securities laws or NASDAQ rules, provided that Seller shall have a reasonable opportunity to review such disclosures in advance.

6.3 Authorizations

Seller shall use commercially reasonable efforts to assist Purchaser in obtaining all Authorizations necessary to consummate the transactions contemplated hereby.

6.4 Compliance with Laws

Seller understands that Seller's operation of the Business prior to the Closing of this Agreement is subject to the rules and regulations of the FCC and the PSCs, and Seller hereby agrees to be fully responsible for the acts and omissions of all of Seller's agents, servants and representatives in the connection with the operation of the Business prior to the Closing of this Agreement which are in violation of all laws, rules, regulations, administrative decisions and pronouncements of the FCC and the PSCs, including but not limited to all applicable FCC and PSC rules regarding customer slamming and cramming, the violation of which may result in severe penalties and adverse consequences which the FCC or the PSCs agencies may attempt to impose upon Purchaser after the Closing of this Agreement.

6.5 Bulk Sales

Purchaser and Seller hereby agree to waive compliance with any and all applicable bulk sales laws.

6.6 Continued Relationships

Up to the Closing Seller shall use commercially reasonable efforts to preserve intact the Business and keep available the services of its officers and employees and operate the Business in its ordinary course, and shall cause to be taken no change in the business, condition or results of operations of Seller which may have a material adverse effect on the Business.

6.7 Confidentiality

(a) The provisions of that certain Confidentiality Agreement executed by and between Purchaser as of _____ (the "Confidentiality Agreement") are incorporated herein by reference. Notwithstanding the foregoing, the Confidentiality Agreement shall survive any termination of this Agreement.

(b) Notwithstanding the foregoing, Purchaser or PGE may, at any time after the date of this Agreement, file with the Securities and Exchange Commission (the "Commission") a Report on Form 8-K pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), with respect to the transactions contemplated by this Agreement, which Report may include, among other things, financial statements and pro forma financial information with respect to the Business, and/or file with the Commission a registration statement under the Securities Act which includes a prospectus containing any information required to be included therein with respect to the transactions contemplated by this Agreement, including but not limited to financial statements and pro forma financial information with respect to the Business, and thereafter distribute said prospectus in connection with the offer and sale of securities of Purchaser or PGE. Purchaser or PGE also may include such information in any other Exchange Act Report or in offering circulars or private placement memoranda distributed in connection with the offer and sale of debt or equity securities. Seller shall cooperate with Purchaser or and provide such information and documents as may be required in connection with any such filings, registration statements, offering circulars or Exchange Act Reports.

6.8 Stock Sale Agreement

A Stock Sale Agreement, in substantially in the form attached hereto as **Exhibit 6.8** (the "Stock Sale Agreement") shall be executed by Purchaser, Seller and PGE at the Closing.

6.9 Current Information

From and after the Closing Date, and for so long as Seller or any affiliate of Seller hold shares of PGE Common Stock, Purchaser agrees to use its best efforts to ensure that PGE files all reports required to be filed by it under the reporting requirement of Section 13 or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended (the "Act"); or, if PGE is not subject to Section 13 or 15(d) of the Act, PGE shall make publicly available, on a current basis,

the information specified in Rule 144(c)(2) promulgated under the Securities Act. As used in this section, the term "affiliate" shall have the same meaning as in Rule 501 promulgated under the Securities Act.

6.10 Bringdown Certificate

As of the Closing, Seller shall deliver to Purchaser a Bringdown Certificate with respect to Seller's representations and warranties set forth in this Agreement. In the event that such Bringdown Certificate does not set forth facts or circumstances which have a material adverse impact on the Assets, then Seller's representations and warranties shall be deemed modified as set forth in such Certificate. In the event that such Bringdown Certificate sets forth facts or circumstances which have a material adverse impact on the Assets, then Purchaser's sole and exclusive remedy shall be to elect to terminate this Agreement; provided in the event (i) Seller took some action between _____ and the Closing which results in regulatory consequences having a material adverse effect on the Business or (ii) there is a twenty-five percent (25%) reduction in the gross revenues of the Business between _____ and the Closing, then Purchaser shall also be entitled to the return of the Breakup Shares. In the event that Purchaser closes the transactions contemplated by this Agreement following receipt of such Bringdown Certificate, then Purchaser shall be deemed to have waived any claims with respect to the matters set forth in such Bringdown Certificate.

6.11 Due Diligence

Purchaser shall have completed, to its satisfaction, a due diligence review of the Business and delivered to Seller by _____ either a Satisfaction Notice or a written notice terminating this Agreement. In the event Purchaser fails to deliver such notice, then this Agreement shall be deemed to have terminated. In the event of such termination or deemed termination, this Agreement shall be of no further force and effect and Seller shall be entitled to retain the Breakup Cash and, except as otherwise expressly provided herein, the Breakup Shares.

6.12 Integration

On or before the Closing, Purchaser shall provide Seller with all necessary information and data to integrate all of Purchaser's long distance customer accounts and casual calling traffic into the Business (other than the Customer Accounts). The scope, extent and nature of such accounts and casual calling traffic shall be substantially as set forth on Schedule 6.12 attached hereto. Following the Closing, Seller shall on a best efforts basis integrate such customer accounts into the Business. Purchaser shall fully cooperate with such integration. Upon integration of such customer accounts, Seller shall commence billing such customer accounts pursuant to the Management Agreement.

6.13 SOHO Agreement

The parties may, but are not obligated to agree in the future to form a joint venture for the purpose of marketing telecommunications services to small office/home office customers.

7. Conditions Precedent

7.1 Conditions to Obligations of Purchaser

The obligation of Purchaser to pay the Purchase Consideration to Seller and to satisfy its other obligations hereunder shall be subject to fulfillment (or waiver by Purchaser) at or prior to the Closing, of the following additional conditions, which Seller agrees to use its best efforts to cause to be fulfilled:

(a) Representations, Performance

The representations and warranties of Seller contained in **Section 3** hereof shall be true in all material respects at and as of the Closing Date (except as otherwise provided herein or as affected by the transactions contemplated hereby) and Seller shall have duly performed and complied with all agreements and conditions required by this Agreement to be performed, or complied with, by it prior to or on the Closing Date.

(b) Partnership Proceedings

All partnership and other proceedings of Seller in connection with the transactions contemplated by this Agreement and all document and instruments incident to such partnership proceedings, shall be reasonably satisfactory in substance and form to Purchaser, and Purchaser shall have received all such documents and instruments or copies thereof.

(c) Approval of FCC and States

The FCC and the PUCs shall have granted any and all consents and approvals necessary to consummate the transactions contemplated hereby and any required notice period(s) shall have expired.

(d) Consents

Seller shall have successfully arranged for the Consents necessary to assign the Contracts being assumed by Purchaser from Seller to Purchaser.

(e) Non-Competition Agreement

Seller shall have executed a non-competition agreement, substantially in the form attached hereto as **Exhibit 7.1(e)** (the "**Non-Competition Agreement**").

(f) Stock Sale Agreement

Seller shall have executed the Stock Sale Agreement referred to in Section 6.8 above.

(g) Expense Sharing

Seller shall share on an equal basis the monthly expenses set forth on Schedule 7.1(g) attached hereto (the "**Expense Sharing Arrangement**"). The Expense Sharing

Arrangement shall continue for an initial period of six (6) months from the Closing Date (the "Initial Period") and shall automatically be renewed for consecutive additional periods of six (6) months, provided however that either party (the "Terminating Party") may terminate the Expense Sharing Arrangement at any time after the Initial Period upon providing the other party (the "Non-Terminating Party") with sixty (60) days prior written notice of the Terminating Party's intent to so terminate effective as of the expiration of such sixty (60) day period. In conjunction therewith Purchaser shall utilize the Los Angeles telemarketing and support operations center located at 3660 Wilshire Boulevard, Los Angeles, California (which lease is subject to a Non Customer Contract) (the "L.A. Center") during nights and weekends and Seller shall utilize the L.A. Center during the weekdays. All other expenses related to the L.A. Center shall be borne by Purchaser pursuant to the lease in respect of the L.A. Center.

(h) **Due Diligence**

Purchaser shall have completed, to its satisfaction, a due diligence review of the Business by

(i) **License Agreement**

Seller shall have executed and delivered to Purchaser a License Agreement substantially in the form of Exhibit 7.1(i) attached hereto (the "License Agreement").

(j) **Management Agreement**

Seller shall have executed and delivered to Purchaser a Management Agreement substantially in the form of Exhibit 7.1(j) attached hereto (the "Management Agreement").

7.2 Conditions to Obligations of Seller

The obligations of Seller to deliver the bill of sale, assignments, endorsements and other instruments of transfer relating to the Assets and to satisfy Seller's other obligations hereunder shall be subject to the fulfillment, on or prior to the Closing Date (or waiver by Seller), of the following conditions, which Purchaser agrees to use its best efforts to cause to be fulfilled:

(a) **Representations, Performance**

The representations and warranties of Purchaser contained in **Section 4** hereof shall be true at and as of the Closing Date. Purchaser shall have duly performed and complied in all material respects with all agreements and conditions required by this Agreement to be performed, or complied with, by it prior to or on the Closing Date.

(b) **Corporate Proceedings**

All corporate and other proceedings of Purchaser in connection with the transactions contemplated by this Agreement, and all documents and instruments incident thereto, shall be satisfactory to Seller and Seller shall have received all such documents and instruments, or copies thereof.

(c) **No Material Changes**

No material changes in the financial position of Purchaser or material changes in the written information previously disclosed to Seller shall have occurred.

(d) **Delivery of Purchase Consideration**

Seller shall have been paid the Cash Purchase Price in accordance with Section 2.3 hereof and shall have received bona fide certificates evidencing the Purchase Price Shares (if applicable) executed by the person or persons required to so execute such certificates in accordance with the formative corporate documents of PGE.

(e) **Adequate Security**

Purchaser shall provide Seller with adequate security for the (i) delivery of the Earn-Out Shares, (ii) delivery of the Additional Shares, (iii) payment of any portion of the Cash Purchase Price which is to be paid subsequent to the Closing Date and (iv) payment of the funds to Seller pursuant to Section 2.3 (viii) of this Agreement, which security may, in Purchaser's sole and absolute discretion, be in the form of any combination of the following: (i) an irrevocable letter of credit from a national bank; or (ii) escrowed cash; or (iii) a first priority perfected security interest in the Assets and all new and replacement assets comprising the Business as owned by Purchaser after the Closing (such security interest shall be reflected in security documents in form and substance acceptable to Seller). In the event Seller is provided a security interest as set forth in item (iii) above and there is a default by Purchaser in the obligations secured thereby then Seller shall be entitled to elect, in its sole and absolute discretion, to receive the assets secured by such security interest (the "Secured Assets") in full satisfaction of such obligations. In the event of such election Seller shall be entitled to retain all stock, cash or other consideration received by Seller pursuant to the terms of this Agreement prior to the date of such election; provided, however, if on the date of such election Seller shall have received more than sixty percent (60%) of the Purchase Consideration then upon receipt by Seller of good and marketable title to the Secured Assets free and clear of all liens, claims, charges, security interests, options or other title defects or encumbrances Seller shall pay to Purchaser the difference between (A) the Purchase Consideration actually received by Seller and (B) sixty percent (60%) of the Purchase Consideration.

(f) **License Agreement**

Purchaser shall have executed and delivered the License Agreement to Seller.

(g) **Management Agreement**

Purchaser shall have executed and delivered the Management Agreement to Seller.

8. Indemnification; Manner of Claims

8.1 Indemnification

(a) Indemnification by Seller

From and after the Closing Date, Seller will indemnify Purchaser against, and hold Purchaser harmless from, any and all liability, damage, deficiency, loss, cost or expense (including reasonable attorneys fees') (collectively "Losses") that is based upon or that arises out of (i) any misrepresentation or breach of any representation, warranty or agreement made by Seller herein, (ii) any obligation, debt or liability of Seller to the extent that the same is not expressly assumed herein by Purchaser, or (iii) the use and ownership of the Assets on or prior to the Closing Date (other than those liabilities specifically assumed by Purchaser hereunder or liabilities which Purchaser or its affiliates are responsible for pursuant to various contracts and agreements entered into between Purchaser and its affiliates on the one hand and Seller and its affiliates on the other hand), provided that Purchaser may not receive recoveries in excess of the amount of Loss.

(b) Indemnification by Purchaser

From and after the Closing Date, Purchaser will indemnify Seller against, and hold Seller harmless from, any and all Losses based upon or that arising out of (i) any misrepresentation or breach of any representation, warranty or agreement made by Purchaser herein, (ii) the use and ownership of the Assets subsequent to the Closing Date (other than those liabilities which Seller or its affiliates are responsible for pursuant to various contracts and agreements entered into between Seller and its affiliates on the one hand and Purchaser and its affiliates on the other hand), and (iii) any obligation, debt, liability or Contract of Seller assumed by Purchaser pursuant hereto.

(c) Cap and Floor

Notwithstanding anything to the contrary in this Agreement, Seller shall have no liability or obligation to Purchaser with respect to that portion of the Losses which are (a) less than _____ in the aggregate or (b) greater than _____ in the aggregate.

(d) Exclusive Remedy

Except as otherwise expressly provided for in this Agreement, the rights under this Section 8.1 shall constitute Purchaser's exclusive rights against Seller for the matters set forth in this Agreement.

8.2 Manner of Claims

Any notice of a claim by reason of any of the representations and warranties contained in this Agreement shall state specifically the representation or warranty with respect to which the claim is asserted, and the amount of liability asserted against the other party by reason of the claim.

9. Miscellaneous

9.1 Consents of Third Parties

This Agreement shall not constitute an agreement to assign any interest in any instrument, Contract, lease, permit, Authorization or other agreement or arrangement of Seller, or any claim, right or benefit arising thereunder or resulting therefrom, if any assignment without the consent of a third party would constitute a breach or violation thereof or adversely affect the rights of the Purchaser or Seller thereunder. If a consent of a third party which is required in order to assign any instrument, Contract, lease, permit, Authorization or other agreement or arrangement or any claim, right or benefit arising thereunder or resulting therefrom, which consent Seller shall use its best efforts to assist Purchaser in obtaining prior to the Closing, is not obtained prior to the Closing, or if an attempted assignment would be ineffective or would adversely affect the ability of Seller to convey its interest to the Purchaser, Seller will cooperate with Purchaser in any lawful and economically feasible arrangement to provide that Purchaser shall receive Seller's interest in the benefits under any such instrument, Contract, lease, permit, Authorization or other agreement or arrangement; and any transfer or assignment to Purchaser by Seller of any interest under any such instrument, Contract, lease, permit, Authorization or other agreement or arrangement that requires the consent of a third party shall be made subject to such consent or approval being obtained.

9.2 Expenses

Subject to the terms of Sections 8 and 10 hereof, each of the parties hereto shall bear its own expenses, costs and fees (including attorney's fees) in connection with the transactions contemplated hereby, including the preparation and execution of this Agreement and compliance herewith, whether or not the transactions contemplated hereby shall be consummated.

9.3 Severability

If any term or provision of this Agreement shall be held or deemed to be, or shall in fact be, inoperative or unenforceable as applied in any particular case because it conflicts with any other provision or provisions hereof or any constitution or statute or rule of public policy, or for any other reason, such circumstances shall not have the effect of rendering the term or provision in question inoperative or unenforceable in any other case or circumstance, or of rendering any other provision or provisions herein contained invalid, inoperative, or unenforceable to any extent whatever, but such term or provision shall be deemed modified or deleted as or to the extent required by applicable law. The invalidity of any one or more phrases, sentences, clauses, sections, or subsections of this Agreement shall not affect the remaining portions of this Agreement.

9.4 Notices

Any notices or other communications required under this Agreement shall be in writing, shall be deemed to have been given when delivered in person, when delivered to a recognized next business day courier, or, if mailed, when deposited in the United States first

class mail, registered or certified, return receipt requested, with proper postage prepaid, addressed as follows or to such other address as notice shall have been given pursuant hereto:

If to Seller:

NOSVA Limited Partnership

Attn: Michael Arnau
4380 Boulder Highway
Las Vegas, NV 89121

With a copy to:

Ronald D. Husdon, Esq.
Kelley Drye & Warren LLP
777 South Figueroa Street
Suite 2700
Los Angeles, CA 90017

If to Purchaser:

International Exchange Communications, Inc.
Attn: Gail E. Granton
533 Airport Blvd., Suite 505
Burlingame, CA 94010

With a copy to:

Benjamin W. Bronston, Esq.
Nowalsky, Bronston & Gothard
A Professional Limited Liability Company
3500 N. Causeway Blvd.
Suite 1442
Metairie, LA 70002

9.5 Amendment

This Agreement may not be amended except by an instrument in writing, duly executed and delivered on behalf of each of the parties hereto.

9.6 Waiver

Any party may waive compliance by another with any of the provisions of this Agreement. No waiver of any provisions shall be construed as a waiver of any other provision. Any waiver must be in writing.

9.7 Counterparts

This Agreement may be executed in multiple counterparts, each of which shall be deemed an original agreement, and all of which taken together shall constitute one agreement, notwithstanding that all of the parties are not signatories to the original or to the same counterpart.

9.8 Assignment

Any assignment of this Agreement or the rights or obligations hereunder by any party without the prior written consent of the nonassigning parties shall be void. Notwithstanding the foregoing, either party may assign all or any part of its rights and/or obligations to one or more affiliates, subsidiaries, parent companies or shareholders of said party. No such assignment shall relieve the assigning party of any of its obligations or duties under this Agreement.

9.9 Costs

In the event any action is instituted to enforce or interpret the terms of this Agreement or arises out of this Agreement, the party prevailing in such action shall be entitled to recover its reasonable attorney's fees and costs as determined by the court.

9.10 Entire Agreement; Applicable Law, etc.

This Agreement, the Confidentiality Agreement and the other documents or agreements executed contemporaneously herewith or pursuant hereto constitutes the entire agreement and supersedes all prior agreements and understandings, both written and oral, among the parties with respect to the subject matter hereof. This Agreement shall be governed in all respects, including validity, interpretation and effect, by the laws of the State of California applicable to contracts made and to be performed in California.

9.11 Industry Terms and Phrases

All terms and phrases unique to the telecommunications industry and used within this Agreement shall be defined in accordance with the everyday meaning assigned to such terms and phrases within the industry.

9.12 Stock Legend

Each of the certificates of PGE Common Stock issued to Seller pursuant to the transactions hereunder, shall bear the following legend:

THE SHARES OF COMMON STOCK REPRESENTED BY THIS
CERTIFICATE MAY NOT BE SOLD, TRANSFERRED OR OTHERWISE DISPOSED OF
BY THE HOLDER EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION
STATEMENT FILED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, WITH
RESPECT THERETO OR IN ACCORDANCE WITH AN OPINION OF COUNSEL IN FORM
AND SUBSTANCE SATISFACTORY TO THE ISSUER THAT AN EXEMPTION FROM

SUCH REGISTRATION IS AVAILABLE. THE SHARES OF COMMON STOCK REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN PROVISIONS OF THAT CERTAIN ASSET PURCHASE AGREEMENT, DATED AS OF 1999 BETWEEN INTERNATIONAL EXCHANGE COMMUNICATIONS, INC. AND NOSVA LIMITED PARTNERSHIP AND THE STOCK SALE AGREEMENT BETWEEN INTERNATIONAL EXCHANGE COMMUNICATIONS, INC. AND NOSVA LIMITED PARTNERSHIP, DATED AS OF

9.13 Arbitration

The parties agree that any controversy or claim arising under this Agreement shall be resolved through alternative dispute resolution means in the following manner:

(a) Initially, the parties will engage in nonbinding mediation. Mediation shall be held in Los Angeles, California or such site as is mutually agreeable to both parties. The mediator shall be jointly appointed by the parties and shall have expertise in commercial dispute resolution.

(b) In the event that the dispute of claim is not satisfactorily resolved through mediation within forty-five (45) days of notice of such claim or dispute by a party, the parties agree to submit such dispute or claim to binding arbitration. Arbitration shall be held in Los Angeles, California, or such other site that is mutually agreeable to the parties. Any judgement, decision or award by the arbitrator shall be final and binding on the parties and may be enforced in any court having jurisdiction over a party against whom any such judgement, decision or award is to be enforced. The parties specifically and knowingly waive any rights under State or Federal constitutions or statutes which grant a party the right to trial by jury for any claim that might arise under this Agreement or which purports to give a party the right to appeal an arbitrator's judgement, decision or award. The rules and procedures of the American Arbitration Association shall apply.

(c) The parties shall bear their own costs and expenses, including, but not limited to, attorney's fees, for any mediation or arbitration, unless otherwise directed by the mediator or arbitrator.

10. Termination

10.1 Mutual Consent

This Agreement may be terminated at any time prior to the Closing by mutual consent of Seller and Purchaser, expressed by action of their respective Boards of Directors.

10.2 Automatic Termination

This Agreement shall automatically terminate and, except as otherwise set forth in Section 10.3 below, the obligations of the parties hereunder shall be discharged if the Closing does not occur on or prior to

10.3 Remedies on Termination

In the event Purchaser, without the right to do so under this Agreement, shall fail or refuse to consummate the transactions contemplated by this Agreement, or if any default under, or breach of, any representation, warranty, covenant or condition of this Agreement on the part of Purchaser shall have occurred that results in the failure to consummate the transactions contemplated hereby, then Seller's sole and exclusive remedy shall be to obtain a termination fee in the form of the Breakup Cash (as described in Section 2.3(b)(i) above) plus the Breakup Shares (as described in Section 2.3(c)(i) above) (or any cash which Purchaser may have substituted in lieu of all or any portion of the Breakup Shares pursuant to Section 2.3(c)(vii)). In the event Seller, without the right to do so under this Agreement, shall fail or refuse to consummate the transactions contemplated by this Agreement, or if any default under, or breach of, any representation, warranty, covenant or condition of this Agreement on the part of Seller shall have occurred that results in the failure to consummate the transactions contemplated hereby, then subject to the limitations and exceptions set forth in this Agreement, Purchaser shall be entitled to obtain from Seller reasonable costs and attorneys fees incurred in connection with this Agreement and the right to seek specific performance of Seller's obligations under this Agreement.

10.4 AS-IS SALE; DISCLAIMERS

EXCEPT AS EXPRESSLY SET FORTH IN THIS AGREEMENT, IT IS UNDERSTOOD AND AGREED THAT SELLER IS NOT MAKING AND HAS NOT AT ANY TIME MADE ANY WARRANTIES OR REPRESENTATIONS OF ANY KIND OR CHARACTER, EXPRESS OR IMPLIED, WITH RESPECT TO THE ASSETS OR THE BUSINESS, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OR REPRESENTATIONS AS TO HABITABILITY, MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE.

PURCHASER ACKNOWLEDGES AND AGREES THAT UPON CLOSING SELLER SHALL SELL AND CONVEY TO PURCHASER AND PURCHASER SHALL ACCEPT THE ASSETS "AS IS, WHERE IS, WITH ALL FAULTS" EXCEPT AS OTHERWISE SET FORTH HEREIN. EXCEPT AS EXPRESSLY SET FORTH IN THIS AGREEMENT, PURCHASER HAS NOT RELIED AND WILL NOT RELY ON, AND SELLER IS NOT LIABLE FOR OR BOUND BY, ANY EXPRESS OR IMPLIED WARRANTIES, GUARANTIES, STATEMENTS, REPRESENTATIONS OR INFORMATION PERTAINING TO THE ASSETS OR THE BUSINESS OR RELATING THERETO, MADE OR FURNISHED BY SELLER OR ANY AGENT REPRESENTING OR PURPORTING TO REPRESENT SELLER, TO WHOMEVER MADE OR GIVEN, DIRECTLY OR INDIRECTLY, ORALLY OR IN WRITING. PURCHASER ALSO ACKNOWLEDGES THAT THE PURCHASE PRICE REFLECTS AND TAKES INTO ACCOUNT THAT THE ASSETS ARE BEING SOLD "AS-IS."

PURCHASER REPRESENTS TO SELLER THAT PURCHASER HAS CONDUCTED, OR WILL CONDUCT PRIOR TO CLOSING, SUCH INVESTIGATIONS OF THE ASSETS AND THE BUSINESS, AS PURCHASER DEEMS NECESSARY OR DESIRABLE TO SATISFY ITSELF AS TO THE CONDITION OF THE ASSETS AND THE

BUSINESS, AND WILL RELY SOLELY UPON SAME AND THE EXPRESS REPRESENTATIONS AND WARRANTIES SET FORTH IN THIS AGREEMENT AND NOT UPON ANY INFORMATION PROVIDED BY OR ON BEHALF OF SELLER OR SELLER'S AFFILIATES, EMPLOYEES OR AGENTS WITH RESPECT THERETO. UPON CLOSING, PURCHASER SHALL ASSUME THE RISK THAT ADVERSE MATTERS MAY NOT HAVE BEEN REVEALED BY PURCHASER'S INVESTIGATIONS.

IN WITNESS WHEREOF, the parties have duly executed this Agreement as of the date first written above.

**International Exchange Communications,
Inc.**

By: _____
Name: _____
Title: _____

NOSVA Limited Partnership

**NOS Communications of Virginia, Inc.,
Its General partner**

By: _____
Name: _____
Title: _____

INTERVENTION

And now comes Pacific Gateway Exchange, Inc., a Delaware corporation, for purposes of intervening into this Asset Purchase Agreement and agreeing to be bound by the terms of Sections 2.2(b)(ii), 2.2(b)(iii), 2.3(a), 2.3(c), 4.5, 6.8, 6.9, 7.2(d), 7.2(e) and 10.3, but not any other provisions hereof.

Pacific Gateway Exchange, Inc.

By: _____
Name: _____
Title: _____

Exhibit "B"
Financial Information

<!--StartFragment-->UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED June 30, 1999

COMMISSION FILE NUMBER 000-21043

PACIFIC GATEWAY EXCHANGE, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware 94-3134065

(State of Other Jurisdiction (IRS Employer
of Incorporation or Organization) Identification Number)

500 Airport Blvd, Suite 340, Burlingame, California, 94010

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code (650) 375 6700

None

(Former Name, Former Address and
Former Fiscal Year if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the
registrant was required to file such reports), and (2) has been subject to such
filing requirements for the past 90 days.

Yes ☒ X No ☐

At July 29, 1999, the number of the registrant's Common Shares of \$.0001 par
value outstanding was 19,488,217.

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June 30, 1999 and 1998

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June 30, 1999 and 1998

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Item 1. Financial Statements

PACIFIC GATEWAY EXCHANGE, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

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ASSETS

Current Assets:

Cash and cash equivalents
Accounts receivable, net of allowance for doubtful
accounts of \$5,726 in 1999 and \$4,312 in 1998

Prepaid expenses
Income taxes receivable
Deferred income tax
Other current assets

Total current assets

Property and equipment:
Undersea fiber optic cables
Long distance communications equipment
Computers and office equipment
Leasehold improvements
Construction in progress
Cable construction in progress

Less: accumulated depreciation

Total property and equipment, net
Deposits and other assets

Total assets

(Unaudited)
June 30,
1999
December 31,
1998
<C>
<C>

\$ 16,170	\$ 30,041
114,503	87,725
1,932	1,244
2,286	1,358
2,286	2,207
	1,408
137,177	123,983
36,422	34,663
68,133	48,710
13,680	9,352
3,654	2,004
9,861	13,587
21,166	12,066
152,916	120,382
23,592	17,335
129,324	103,047
15,056	8,607
\$ 281,557	\$ 235,637

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:

Accounts payable
Accrued liabilities
Income taxes payable
Line of credit
Other liabilities

Total current liabilities
Other non-current liabilities

Total liabilities

\$ 132,026 \$ 118,303

5,248 4,193
4,623 -
21,700 8,700
646 1,740

164,243 132,936
4,898 2,062

169,141 134,998

Stockholders' Equity:

2

2

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1/11/00

Additional paid in capital
Deferred compensation-restricted stock
Foreign currency translation
Retained earnings
Common stock held in treasury, at cost

0
a

Total stockholders' equity
Total liabilities and stockholders' equity

	72,467	65,431
	(5,197)	(4,618)
	(1,441)	34
	46,985	40,190
	(400)	(400)
	112,416	100,639
	\$ 281,557	\$ 235,637

</TABLE>

See accompanying Notes to Consolidated Condensed Financial Statements

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PACIFIC GATEWAY EXCHANGE, INC.
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
(in thousands, except net income per share)

<TABLE>
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Three Months
Ended June 30,

1999 1998

Six Months
Ended June 30,

1999 1998

(Unaudited)

(Unaudited)

<C>

<C>

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<C>

<S>
Revenues
Cost of long distance services

\$ 139,586
121,433

\$ 109,952
92,951

\$ 280,115
242,868

\$ 215,024
182,192

Gross margin
Selling, general, and administrative expenses
Depreciation and amortization

10,153
11,630
3,340

17,001
7,290
2,146

37,247
21,621
6,386

32,832
14,852
4,109

Total operating expenses

14,970

9,436

20,007

18,961

Operating income
Interest income, net
Other (income) expense, net

3,183
(249)
(524)

7,565
(556)
496

9,240
(467)
(747)

13,871
(1,169)
594

Income before income taxes
Provision for income taxes

3,956
1,385

7,625
2,740

10,454
3,659

14,446
5,185

Net income

\$ 2,571

\$ 4,885

\$ 6,795

\$ 9,261

Net income per share - basic

\$ 0.13

\$ 0.26

\$ 0.35

\$ 0.49

Net income per share - diluted

\$ 0.13

\$ 0.25

\$ 0.34

\$ 0.46

Weighted-average number of common shares
outstanding - basic

19,207

19,060

19,170

19,041

Weighted-average number of common shares
outstanding - diluted

20,342

19,934

20,057

</TABLE>

See accompanying Notes to Consolidated Condensed Financial Statements.

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PACIFIC GATEWAY EXCHANGE, INC.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(in thousands)

<TABLE>
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Six Months Ended June 30,	
1999	1998
(Unaudited)	
<C>	<C>

<S>

Operating Activities:

Net income

Adjustments to net income:

Depreciation and amortization

Stock compensation expense

Bad debt provision

Equity in earnings of affiliated companies, net

Changes in operating assets and liabilities:

Accounts receivable

Prepaid expenses

Income taxes receivable

Deferred income tax

Other current assets

Deposits and other assets

Accounts payable

Accrued liabilities

Income taxes payable

Other liabilities

Net cash provided by operating activities

Investing Activities:

Purchase of property and equipment

Investments in subsidiaries and affiliates

Net cash used in investing activities

Financing Activities:

Borrowings on revolving line of credit

http://www.fedex.com/Archives/edgar/data/1004967/0000929624-99-001579.txt

\$ 6,795 \$ 9,261

6,386 4,108

434 304

1,383 1,204

977 152

(26,904) (22,110)

(688) (361)

1,358 -

(79) -

(878) -

(1,573) 953

11,653 10,807

1,055 241

4,623 (554)

1,742 409

6,284 4,414

(32,578) (13,988)

(1,850) (3,314)

(34,428) (17,302)

13,000 360

1,273

1/1/00

Other

Net cash provided by financing activities

Net decrease in cash and cash equivalents
Cash and cash equivalents at beginning of the period

Cash and cash equivalents at end of the period

Supplemental data for non-cash investing activities:
Common stock issued to investee

</TABLE>

See accompanying Notes to Consolidated Condensed Financial Statements.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(1) GENERAL

The financial statements included herein are unaudited and have been prepared in accordance with generally accepted accounting principles for interim financial reporting and Securities Exchange Commission ("SEC") regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the financial statements reflect all adjustments (of a normal and recurring nature) that are necessary to present fairly the financial position, results of operations, and cash flows for the interim periods. These financial statements should be read in conjunction with the annual report on Form 10-K of Pacific Gateway Exchange, Inc. (the "Company" or "Pacific Gateway") for the year ended December 31, 1998. The results for the three- and six-month periods ended June 30, 1999, are not necessarily indicative of the results that may be expected for future periods.

Certain prior-year amounts have been reclassified to conform to the 1999 financial statement presentation.

(2) EARNINGS PER SHARE

<TABLE>
<CAPTION>

JAN 11 10:55AM NOWALSKY&BRONSTON

(in thousands, except per share amounts)

<S> Three Months Ended June 30, 1999

Basic EPS

Effect of dilutive stock options and restricted stock

Diluted EPS

Income	Shares	Amount
<C>	<C>	<C>

\$2,571	19,207	\$ 0.13
-	1,135	-

\$2,571	20,342	\$ 0.13
---------	--------	---------

Three Months Ended June 30, 1998

Basic EPS

Diluted EPS

Income	Shares	Amount
<C>	<C>	<C>

\$4,885	19,060	\$ 0.26
-	874	(0.01)

\$4,885	19,934	\$ 0.25
---------	--------	---------

Six Months Ended June 30, 1999

Basic EPS

Diluted EPS

Income	Shares	Amount
<C>	<C>	<C>

\$6,795	19,170	\$ 0.35
-	887	(0.01)

\$6,795	20,057	\$ 0.34
---------	--------	---------

Six Months Ended June 30, 1998

Basic EPS

Diluted EPS

Income	Shares	Amount
<C>	<C>	<C>

\$9,261	19,041	\$ 0.49
-	890	(0.03)

\$9,261	19,931	\$ 0.46
---------	--------	---------

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(3) COMPREHENSIVE INCOME

Comprehensive income includes all changes in equity (net assets) during a period from non-owner sources. Comprehensive income includes foreign currency translation adjustments, which are excluded from net income. In accordance with the adoption of SFAS No. 130, total comprehensive income was \$2.1 million and \$5.3 million for the three- and six-month periods ended June 30, 1999, respectively. Comprehensive income included foreign currency translation losses.

(4) ACQUISITIONS AND INVESTMENTS

JAN 11 10:55AM NOWALSKY&BRONSTON

Tel, Inc. for \$6.6 million, consisting of \$1.85 million in cash and \$4.75 million in the Company's common stock. The customer base of over 28,000 is mainly Chinese and Vietnamese-American residences and small businesses. There were \$1.3 million of accounts receivable and \$0.6 million of accounts payable; under purchase accounting the excess of the aggregate purchase price over the net assets acquired resulted in total goodwill of \$5.9 million, which will be amortized over 20 years.

(5) SEGMENT INFORMATION

Based primarily on services provided and geographic areas, the Company's current operating segments are: U.S. wholesale, offshore, and value-added services. The Company's management regularly reviews the operating results of these segments; these segment results are integral to management's decision making process.

U.S. wholesale provides international telecommunications services to U.S.-based carriers that originate international traffic, but do not have operating agreements with foreign carriers. U.S. wholesale also provides service to existing international carriers who terminate their overflow telecommunications traffic on its system. Additionally, U.S. wholesale provides service to customers with smaller traffic volumes.

Revenues from the Company's offshore operations are generated from country-specific, usage-sensitive rates charged to the Company's carrier customers and from traffic terminated in its international switching facilities. The Company operates switching facilities in the United Kingdom, Russia, New Zealand, Japan, and Australia. In addition, the Company earns revenues from traffic originating in Germany, Switzerland, Italy, and France.

The value-added segment includes a variety of emerging retail and wholesale services. Through this operating segment, the Company provides international long distance services to the Filipino, Japanese, Chinese, Vietnamese, Russian, Korean, and Romanian-American communities.

Corporate and other includes cash, equity investments, and other miscellaneous current and non-current assets. These assets are not allocated to the three operating segments.

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NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(5) SEGMENT INFORMATION (Continued)

The results of operations for the Company's operating segments for the three- and six-month periods ended June 30, 1999, and 1998, were:

<CAPTION>

(in thousands)

<S>

Three Months Ended June 30, 1999

Total sales

Sales and transfers between segments

Revenues

Depreciation and amortization

Operating income

U.S. Wholesale	Offshore	Value- Added	Corporate And Other	Total
<C>	<C>	<C>	<C>	<C>

\$131,496	\$ 29,039	\$ 8,276	\$ -	\$168,811
(21,415)	(7,810)	-	-	(29,225)

\$110,081	\$ 21,229	\$ 8,276	\$ -	\$139,586
\$ 2,601	705	34	-	\$ 3,340

\$ 613	\$ 1,054	\$ 1,516	\$ -	\$ 3,183
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Three Months Ended June 30, 1998

Total sales

Sales and transfers between segments

Revenues

Depreciation and amortization

Operating income

\$105,545	\$ 16,089	\$ 4,653	\$ -	\$126,287
(12,319)	(4,016)	-	-	(16,335)

\$ 93,226	\$ 12,073	\$ 4,653	\$ -	\$109,952
\$ 1,713	432	1	-	\$ 2,146

\$ 4,917	\$ 1,273	\$ 1,375	\$ -	\$ 7,565
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Six Months Ended June 30, 1999

Total sales

Sales and transfers between segments

Revenues

Depreciation and amortization

Operating income

\$263,539	\$ 60,508	\$14,600	\$ -	\$338,647
(42,383)	(16,149)	-	-	(58,532)

\$221,156	\$ 44,359	\$14,600	\$ -	\$280,115
\$ 5,063	\$ 1,284	39	-	\$ 6,386

\$ 3,338	\$ 3,523	\$ 2,379	\$ -	\$ 9,240
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Six Months Ended June 30, 1998

Total sales

Sales and transfers between segments

Revenues

Depreciation and amortization

Operating income

\$207,129	\$ 32,961	\$ 7,697	\$ -	\$247,787
(23,409)	(9,354)	-	-	(32,763)

\$183,720	\$ 23,607	\$ 7,697	\$ -	\$215,024
\$ 3,320	788	1	-	\$ 4,109

\$ 9,518	\$ 2,818	\$ 1,535	\$ -	\$ 13,871
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Total assets at June 30, 1999

\$198,925	\$ 42,952	\$ 9,167	\$30,513	\$281,557
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Total assets at December 31, 1998

\$151,491	\$ 34,831	\$ 5,857	\$43,458	\$235,637
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Item 2: Management Discussion and Analysis of Financial Condition and Results of Operations

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This Quarterly Report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are statements other than historical information or statements of current condition. Some forward-looking statements may be identified by use of terms such as "believes," "anticipates," "plans," "intends," "expects," "estimates," or other similar expressions. These forward-looking statements relate to the plans, objectives, and expectations of Pacific Gateway Exchange, Inc. ("Pacific Gateway" or the "Company") regarding its future operations or financial performance or related to the Company's expectations regarding the telecommunications industry. In light of the inherent risks and uncertainties of any forward-looking statement, the inclusion of forward-looking statements in this report should not be regarded as a representation by the Company or any other person that the forward-looking statements will come true.

The revenues and results of operations of the Company and future developments in the telecommunications industry are difficult to forecast and could differ materially from those projected in the forward-looking statements as a result of numerous factors, including the following:

1. changes in the ratios between outgoing and incoming traffic and changes in expected future revenue from delayed proportional return traffic from foreign partners pursuant to operating agreements;
2. foreign currency fluctuations;
3. the termination of operating agreements or the inability to enter into additional agreements;
4. inaccuracies in the Company's forecasts of traffic or changes in rates;
5. changes in or developments under domestic or foreign laws, regulations, licensing requirements, or telecommunications standards;
6. foreign political or economic instability;
7. changes in the availability of transmission facilities such as domestic, international, and undersea fiber optic cable or in the feasibility and expense of building or leasing such facilities;
8. loss of the services of key officers, such as:
Howard A. Neckowitz, Chairman of the Board, President and Chief Executive Officer, Gail E. Granton, Chief Operating Officer, Global Marketing and Offshore Development, Thomas J. Murphy, Chief Operating Officer, Network Development and IP Services, or Sandra D. Grey, Chief Financial Officer and Vice President, Finance;
9. loss of a customer that provides significant revenues to the Company;
10. highly competitive market conditions in the industry and rapid technological change;
11. future management decisions regarding acquisitions, capital expenditures, or financing;
12. concentration of credit risk;
13. natural disasters and catastrophic events;
14. network outages, failures, or computer viruses;
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16. difficulties that may be encountered in the development of bandwidth facilities; including construction delays, regulatory obstacles, and the availability of opportunities for additional bandwidth purchases;
17. uncertainties in the development of ethnic marketing programs and new or expanded business lines, such as the Company's commencement of Internet operations and sales to switchless resellers relating to competitive conditions and the difficulty of hiring appropriate personnel;
18. Internet growth at slower rates than expected due to market conditions; or
19. any failure of our computer systems or the computer systems of third parties that are material to our operations (such as computer systems of service providers, suppliers, and brokers) to process information after December 31, 1999.

The foregoing review of important factors, including those discussed in detail below, should not be construed as exhaustive. The Company undertakes no obligation to release publicly the results of any future revisions it may make to forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

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Overview

Pacific Gateway Exchange was founded in August 1991 to capitalize on the significant growth opportunities in the international telecommunications services market. Since then, the Company has undertaken four strategic initiatives in response to regulatory and technological developments: (1) as foreign countries deregulated their telecommunications markets, the Company started foreign wholesale operations; (2) in response to technological innovation and consumer demand, the Company entered the market for retail services; (3) through strategic capital investments, the Company has become a global player in the burgeoning market for high bandwidth capacity so that it will be positioned to meet the emerging demand for higher bandwidth services created by the advent of the Internet and future technological developments; and (4) the Company will begin providing Internet Protocol ("IP") and data services in 1999 and plans to provide connectivity, co-location, and managed services to the Internet community. To accelerate the growth of all of its business lines, the Company may consider acquisition possibilities.

The Company expects its telecommunication services, bandwidth sales, and Internet services to increase revenues. The Company is increasing its customer base and developing low-cost termination arrangements to increase its telecommunication services revenues. In addition, the Company expects to generate revenues from bandwidth sales and Internet services later in 1999 and beyond.

The Company expects that telecommunication services prices will continue to decrease as a result of increased competition and deregulation and that bandwidth capacity prices will decrease due to technological advances and increased cable network construction.

<http://www.sec.gov/Archives/edgar/data/1004967/0000929624-99-001579.txt>

The Company has experienced decreasing telecommunication services gross margins as a result of decreasing prices. These decreases have been partially offset by lower costs of providing services, which the Company expects to continue to decrease due to deregulation and technological advances. In 2000, the Company expects bandwidth sales to contribute substantially to its gross margin. Thereafter, as the Company invests in new cable systems and sells bandwidth capacity, it expects bandwidth sales to further contribute to its gross margin. After incurring initial losses due to start-up costs, the Company expects Internet services to contribute to its gross margin beginning in the fourth quarter of 2000.

The Company currently derives revenues from three operating segments: U.S. wholesale, offshore, and retail and value-added services. U.S. wholesale and offshore revenues are derived from country-specific, usage-sensitive rates charged to carrier customers and traffic sent by our foreign partners. The retail and value-added segment primarily provides international long distance services to targeted ethnic markets. The Company plans to expand into new ethnic markets in the U.S. and offshore where its wholesale operations provide it a competitive cost base.

The majority of the Company's costs are variable and consist of:

- (1) payments to foreign partners for the termination of traffic;
- (2) payments to other providers of long distance transmission services;
- (3) payment to domestic carriers for the termination of overseas-originated traffic in the U.S. where the Company does not have its own network; and
- (4) payments to local exchange companies for access charges for originating and terminating international and domestic traffic.

Additionally, the Company has begun to sell bandwidth capacity on its global network and in 1999 and beyond, expects to provide Internet services. The Company expects that bandwidth sales and Internet services will constitute two new operating segments. As of July 22, 1999, the Company has agreed to sell over \$73 million in bandwidth capacity pursuant to sales agreements and non-binding memoranda of understanding. The Company will recognize these sales as revenue when it delivers the bandwidth capacity to its customers and it will include construction and related costs for such capacity as a cost of good sold. In certain instances, when the Company sells bandwidth capacity, it will use the proceeds to purchase additional network facilities, which it will record as fixed assets. Additionally, the Company expects to generate Internet service revenues, including connectivity and co-location services, beginning in the fourth quarter of 1999.

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Results of Operations

The following table sets forth statements of operations data as a percentage of revenues for the periods indicated.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
<S>	<C>	<C>	<C>	<C>
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of long distance services	87.0%	84.5%	86.7%	84.7%
Gross margin	13.0%	15.5%	13.3%	15.3%
Selling, general, and administrative expenses	8.3%	6.6%	7.7%	6.9%
Depreciation and amortization	2.4%	2.0%	2.3%	1.9%
Total operating expenses	10.7%	8.6%	10.0%	8.8%
Operating income	2.3%	6.9%	3.3%	6.5%
Interest income, net	-0.1%	-0.5%	-0.1%	-0.5%
Other (income) expense, net	-0.4%	0.5%	-0.3%	0.3%
Income before income taxes	2.8%	6.9%	3.7%	6.7%
Provision for income taxes	1.0%	2.5%	1.3%	2.4%
Net income	1.8%	4.4%	2.4%	4.3%

</TABLE>

The Three-Month Periods Ended June 30, 1999 and 1998

Revenues: Total revenues for the three-month period ended June 30, 1999, increased 27% to \$140 million from \$110 million. This increase resulted from an increase in the number of the Company's wholesale-carrier customers to 210 at June 30, 1999, from 153 at June 30, 1998. Additionally, the Company's retail business grew significantly, resulting in retail revenues of \$8.3 million for the three-month period ended June 30, 1999, compared to \$4.7 million for the three-month period ended June 30, 1998. As a result of these factors, total minutes for the three-month period ended June 30, 1999, increased 49.0% from the three-month period ended June 30, 1998, while the average price per minute charged to customers decreased to \$0.24 in the three-month period ended June 30, 1999, compared to \$0.29 in the same quarter last year. Changes in the terminating country mix with significantly different rates per minute, the U.S., and increases in the incidental U.S. domestic terminating traffic influenced the average customer price per minute.

Gross Margin: Gross margin increased 7% to \$18.2 million in the three-month period ended June 30, 1999, from \$17.0 million in the same period in 1998. As a percentage of revenues, gross margin was 13.0% for the three-month period ended June 30, 1999, a decrease from 15.5% in the same period in 1998. Increased competition continues to drive prices downward resulting in decreased gross

three-month period ended June 30, 1999, from \$93 million in the three-month period ended June 30, 1998. This increase in costs represents continued growth in outbound traffic on new and existing routes.

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Selling, General, and Administrative Expenses ("SG&A"): SG&A expenses increased 58% to \$11.6 million in the three-month period ended June 30, 1999, from \$7.3 million in the three-month period ended June 30, 1998. As a percentage of revenues, SG&A expenses were 8.3% in the three-month period ended June 30, 1999, up from 6.6% in the same period in 1998. This increase was due primarily to greater personnel and sales commission expenses. The increase in personnel expenses was directly related to the increase in the number of employees in the Company's wholly-owned subsidiaries to 275 at June 30, 1999, from 129 at June 30, 1998. In 1999, the Company hired additional retail and Internet services personnel to support and grow its business. The Company also hired retail back-office and telemarketing personnel to expand its ethnic marketing programs. The Company plans to continue expanding these functions to increase future revenues and it expects to incur start-up costs in the near term to provide Internet services. The increase in sales commission expenses was due to increased revenues.

Depreciation: Depreciation and amortization increased 56% to \$3.3 million in the three-month period ended June 30, 1999, from \$2.1 million in the same period in 1998. Depreciation as a percentage of revenues was 2.4% of revenue for the three-month period ended June 30, 1999, and 2.0% for the same period in 1998. The increase was primarily due to depreciation of additional U.S. wholesale and offshore fiber optic cables and communications equipment acquired since June 30, 1998. Depreciation will continue to increase as the Japan-U.S. and TAT-14 cable systems and related backhaul facilities and Internet services equipment are placed in-service.

Interest: Interest income decreased to \$0.2 million in the three months ended June 30, 1999, from \$0.6 million in the three-month period ended June 30, 1998, due to decreased average cash balances. The Company had \$20.6 million in average cash balances during the three months ended June 30, 1999, compared to \$31.3 in the same period in 1998. If the Company incurs additional debt (See Liquidity and Capital Resources, below), then interest expense will significantly increase. In the near term, the Company would invest the excess cash from a financing arrangement, thereby partially offsetting interest expense with interest income. In addition, the Company will capitalize the interest costs that relate to network and facility construction per SFAS No. 34, "Capitalization of Interest Cost." The Company will depreciate the capitalized interest over the related asset's life.

Income Tax: Income taxes decreased 48% to \$1.4 million in the three-month period ended June 30, 1999, from \$2.7 million in the three-month period ended June 30, 1998, primarily due to decreased operating income. The effective tax rate was 35% in the quarter ended June 30, 1999, and 36% in the quarter ended June 30, 1998.

The Six-Month Periods Ended June 30, 1999 and 1998

Revenues: Total revenues for the six month period ended June 30, 1999, increased 30% to \$280 million from \$215 million in the same period in 1998. This increase resulted from an increase in the number of the Company's wholesale-carrier customers to 210 at June 30, 1999, from 153 at June 30, 1998. Additionally, the Company's retail business grew significantly, resulting in retail revenues of \$14.6 million for the six-month period ended June 30, 1999, compared to \$7.7 million for the six-month period ended June 30, 1998. As a result of these factors, total minutes for the six-month period ended June 30, 1999, increased 48.0% from the six-month period ended June 30, 1998, while the average price per minute charged to customers decreased to \$0.26 in the six-month period ended June 30, 1999, compared to \$0.29 in the same period in 1998. While U.S. wholesale and offshore prices decreased, the Company's higher-margin retail and value-added services operations grew, partially offsetting the lower wholesale price's impact on gross margin.

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Gross Margin: Gross margin increased 1% to \$37.2 million in the six-month period ended June 30, 1999, from \$32.8 million in the same period in 1998. As a percentage of revenues, gross margin was 13.3% in the current six-month period, a decrease from 15.3% in the same period in 1998. Increased competition continues to drive prices downward resulting in decreased gross margins. The cost of long distance service increased to \$242.9 million in the six-month period ended June 30, 1999, from \$182.2 million in the same period in 1998. This increase in costs represents continued growth in outbound traffic on new and existing routes.

Selling, General, and Administrative Expenses ("SG&A"): SG&A expenses increased 44% to \$21.6 million in the six-month period ended June 30, 1999, from \$14.9 million in the same period in 1998. As a percentage of revenues, SG&A expenses were 7.7% in the six-month period ended June 30, 1999, an increase from 6.9% in the same period in 1998. This increase was due primarily to greater personnel, sales commission, and advertising expenses. The increase in personnel expenses was directly related to the increase in the number of employees in the Company's wholly-owned subsidiaries to 275 at June 30, 1999, from 129 at June 30, 1998. In 1999, the Company hired additional retail and Internet services personnel to support and grow its business. The Company also hired retail back-office and telemarketing personnel to expand its ethnic marketing programs. The Company plans to continue expanding these functions to increase future revenues; and it expects to incur start-up costs in the near term to provide Internet services. The increase in sales commission expenses was due to increased revenues.

Depreciation: Depreciation and amortization increased 56% to \$6.4 million in the six-month period ended June 30, 1999, from \$4.1 million in the same period in 1998. Depreciation as a percentage of revenues was 2.3% for the six-month period ended June 30, 1999, and 1.9% for the same period in 1998. The increase was primarily due to depreciation of additional U.S. wholesale and offshore fiber optic cables and communications equipment acquired since June 30, 1998.

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systems and related backhaul facilities and Internet services equipment are placed in-service.

Interest: Interest income decreased to \$0.5 million in the six-month period ended June 30, 1999, from \$1.2 million in the same period in 1998 due to decreased average cash balances. The Company had \$23.4 million in average cash balances during the six months ended June 30, 1999, compared to \$35.5 in the same period in 1998. If the Company incurs additional debt (See Liquidity and Capital Resources, below), then interest expense will significantly increase. In the near term, the Company would invest the excess cash from a financing arrangement, thereby partially offsetting interest expense with interest income. In addition, the Company will capitalize the interest costs that relate to network and facility construction per SFAS No. 34, "Capitalization of Interest Cost." The Company will depreciate the capitalized interest over the related asset's life.

Income Tax: Income taxes decreased 28% to \$3.7 million in the six-month period ended June 30, 1999, from \$5.2 million in the six-month period ended June 30, 1998, primarily due to decreased operating income. The effective tax rate was 35% for the six-month period ended June 30, 1999, and 36% for the six-month period ended June 30, 1998.

Liquidity and Capital Resources

The Company uses its existing cash balances, cash provided by operating activities, existing lines of credit, and debt commitments to finance its operations.

Net cash provided by operating activities was \$6.3 million for the six-month period ended June 30, 1999, compared to \$4.4 million for the six-month period ended June 30, 1998. This increase in cash provided by operating activities was primarily due to greater revenues and increases in income taxes payable and other liabilities. Due to the timing differences in the international settlement process, the Company's accounts receivable turnover varies from its accounts payable turnover. The length of these turnovers is a function of different timing requirements in the Company's agreements with foreign partners. For example, the length of the Company's accounts payable turnover is partially due to its

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accounts payable with foreign partners, which generally have 180-day terms as a result of the six-month lag in the international settlement process.

Net cash used in investing activities was \$34.4 million for the six-month period ended June 30, 1999, compared to \$17.3 million for the six-month period ended June 30, 1998. Capital expenditures for the six-month period ended June 30, 1999, were \$32.6 million, which included \$9.1 million for undersea fiber optic cables in the Japan-U.S. and TAT-14 cable systems. Additional capital expenditures in the period were for offshore transmission equipment. Capital expenditures for the six-month period ended June 30, 1999, totaled \$14 million.

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and were primarily for domestic switches. In addition, in the second quarter of 1999, the Company acquired Robo Tel, Inc., an international long-distance company, for \$1.85 million in cash and \$4.75 million in Pacific Gateway's common stock. In the first quarter of 1998, the Company acquired 16.66% of Ekonom S.A. de C.V. ("Ekonom"), a Mexican multimedia company, for \$3.3 million in cash and \$1.8 million in Pacific Gateway's common stock.

Net cash provided by financing activities was \$14.3 million for the six-month period ended June 30, 1999, and \$0.3 million for the same period in 1998. In 1999, the Company borrowed an additional \$13.0 million under its line of credit (discussed below). The remainder of these cash inflows was from the exercise of stock options.

In December 1998, the Company obtained a one-year, \$30 million credit facility with Bank of America, N.T.&A., and NationsBank/Comtgomery LLC. The Company uses this credit facility to fund its purchase commitments, letters of credit, working capital, and for general corporate purposes. At June 30, 1999, the Company held \$21.7 million in borrowings under this credit facility.

At June 30, 1999, the Company had outstanding commitments of \$160 million, principally for the acquisition of additional ownership in digital undersea fiber optic cables and network equipment. This includes the commitment to purchase undersea fiber optic cable in the US-Japan cable network for \$71 million and in the TAT-14 cable system for \$67 million. The Company's outstanding commitments also include the purchase of Internet routers and switches from Cisco Systems, Inc. and other equipment for its global Internet facilities. As part of its global network expansion, the Company plans to invest substantially in backhaul facilities in Europe, Japan, and the U.S.

As of July 22, 1999, the Company had sold over \$73 million of bandwidth capacity pursuant to sales agreements and non-binding memoranda of understanding. Of the \$73 million in sales, the Company will use \$54 million to expand its global network. Included in those sales and network expansions are the Company's transactions with Williams Communications Group, Inc. In April 1999, the Company agreed to purchase \$30 million of capacity from Williams and Williams agreed to purchase \$30 million of capacity on the Company's trans-Atlantic city center network.

To fund its capital commitments and planned capital expenditures, the Company is exploring financing alternatives, including public or private sales of debt securities or obtaining a new credit facility to replace its \$200 million commitment letter that lapsed in July 1999. The timing and terms of any financing activities will be subject to market conditions.

The Company believes that its existing cash balances, cash provided by operating activities, existing lines of credit, and the proceeds from its anticipated financing activities will be sufficient to meet its outstanding capital commitments, current capital expenditures, and working capital needs in the foreseeable future.

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The "Year 2000" issue is the risk that the Company's internal computer systems, network elements, software applications, and other business systems may not properly reflect or recognize the year 2000. Because many computers and computer applications define dates by the last two digits of the year, "00" may not be properly identified as the year 2000. This error could result in miscalculations or system failures.

The Company views its Year 2000 risks to be: internal information systems; non-financial software; and external noncompliance by vendors and customers.

Internal information systems. The Company's internal information systems were initially designed to be Year 2000 ready. These systems, including the Company's billing system, have been tested in a simulated Year 2000 environment and were determined to be Year 2000 ready. The costs associated with testing Year 2000 readiness were not material.

Non-financial software. The Company has assessed the Year 2000 impact on its other internal systems, primarily its telecommunications switching equipment in the U.S. in Dallas, Los Angeles, and New York and offshore in the UK, New Zealand, Russia, Japan, and Australia and has conducted tests on such systems. The Company is installing software and hardware upgrades for all switching equipment as indicated by the test results. The costs associated with testing and upgrading equipment as a result of the Year 2000 issue are not expected to be material to the Company's business, financial condition, or results of operations. The Company also has identified and is evaluating other operational systems and applications, which the Company believes are not mission critical, such as building operations and individual personal computers used by Company personnel.

Vendors and customer systems. The Company is evaluating its significant vendors and customer's Year 2000 readiness with respect to information systems used by those entities that could impact business with the Company. To the extent that the Company is not satisfied that a vendor is highly likely to be Year 2000 ready, the Company may seek alternate or new vendors. There is no assurance, however, that such third parties will achieve full Year 2000 readiness or that the Company will receive assurances from such third parties. In the event that any of the Company's significant vendors and customers do not successfully and timely achieve Year 2000 readiness and the Company is unable to replace them with new or alternative vendors and customers, the Company's business or operations could be adversely affected.

As part of the Company's Year 2000 risk program, the Company is evaluating scenarios that may occur as a result of the century change. The Company anticipates completing its contingency and business continuity plans designed to mitigate the effects of any significant Year 2000 disruptions by October 1999.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PACIFIC GATEWAY EXCHANGE, INC.

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Dated: August 16, 1999

By: /s/ Howard A. Neckowitz

Howard A. Neckowitz
President and CEO
(Authorized Signatory)

By: /s/ Sandra Grey

Sandra Grey
Chief Financial Officer
(Principal Financial and Accounting Officer)

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Exhibit "C"
Sample Customer Notice

(Form Letter)

NOSVA LP

International Exchange Communications,
Inc.

(Customer Name)
(Address)

Dear Customer:

On _____, International Exchange Communications, Inc. ("IECOM") and NOSVA Limited Partnership ("NOSVA") entered into an agreement whereby, subject to the regulatory approval, the telecommunications assets of NOSVA will be acquired by IECOM, and IECOM will become your telecommunication service provider.

This change in ownership will not affect or in any way disrupt your current service. No charges or fees will be imposed and no rate increase will occur as a result of this transaction. The toll free Customer Service number will remain the same and if you have any questions, please call one of our Customer Service Representatives at

You understand that you are free to choose another long distance carrier. If you should choose another carrier, you may be assessed a charge by your local telephone service provider.

We at International Exchange Communications are pleased to welcome you to our team and would like to express our appreciation for allowing us the opportunity of being your telecommunication service provider. We are confident that you will be pleased with the high quality of our service.